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ABSTRACT

This document presents the texts of four Congressional hearings held in September of 1985 and February and March of 1986 to investigate the effects and the causes of the critical shortage of liability insurance in the United States. The first hearing examines the dimensions of the problem and offers insights into why objectives of having an insurable society are not currently being met for many people. The second hearing calls on representatives of businesses and of cities, towns, and school boards nationwide, many of whom have been affected by the crisis of insurance cancellations and rate increases. Also testifying are representatives of insurance agent organizations who discuss the insurance industry and difficulties faced by clients. The third hearing concentrates mainly on the perspectives of the states in their current responsibilities for regulating insurance. Witnesses at the state level provide information about the current regulatory system. The final hearing calls on witnesses who discuss areas in which the need for improved risk abatement is particularly acute, including the trucking industry. A total of 35 witnesses provide testimony at the four hearings. Materials submitted for the record are included. (NB)

LIABILITY INSURANCE AVAILABILITY
(Part 1)

HEARINGS

BEFORE THE

SUBCOMMITTEE ON COMMERCE, TRANSPORTATION, AND TOURISM

OF THE

COMMITTEE ON ENERGY AND COMMERCE
HOUSE OF REPRESENTATIVES

NINETY-NINTH CONGRESS

SEPTEMBER 19, 1985, FEBRUARY 4 AND 20, AND MARCH 19, 1986

Serial No. 99-141

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LIABILITY INSURANCE AVAILABILITY

THURSDAY, SEPTEMBER 19, 1985

HOUSE OF REPRESENTATIVES
COMMITTEE ON ENERGY AND COMMERCE,
SUBCOMMITTEE ON COMMERCE,
TRANSPORTATION, AND TOURISM,
Washington, DC.

The subcommittee met, pursuant to notice, at 9:35 a.m., in room 2203, Rayburn House Office Building, Hon. James J. Florio (chairman) presiding.

Mr. FLORIO. The subcommittee will kindly come to order.

I would like to welcome all in attendance today to our important hearing that launches a full-scale effort by this committee to investigate the effects and the causes of the critical shortage of liability insurance in this nation.

The investigation comes in response to the hundreds of calls and letters members of this subcommittee have received from businesses, professional groups and others for whom liability coverage has either become prohibitively expensive or impossible to obtain at any price.

The crisis in property casualty insurance is widespread and growing very rapidly. The current list of victims includes architects, trucking and bus companies, commercial fishermen, railroads, nurse-midwives, hotels, taverns, restaurants, ski resort operators, State and local governments that we know of, and I suspect the list is much longer.

Some of the groups will be represented by today's witnesses, but as we listen to their testimony, we should bear in mind that they are only telling part of the story. The organizations and individuals who are being harmed during this crisis are too numerous and diverse to be adequately represented at a single congressional hearing.

It is obvious to me that this is a national problem, deserving of a national response. Availability and affordability of insurance are fundamental in today's society. The lack of either can ultimately determine who can buy a car, who can purchase a home, who can obtain child care, and thus be able to enter the workforce, who can engage in business.

Our hearing this morning will examine the dimensions of the problem and, hopefully, afford insights into why these objectives of having an insurable society are not currently being met for so many.

Our modern society relies on insurance to an astounding degree, one that we could not have imagined 30 or 40 years ago. If there

are problems, and I think the conclusion is that there are, certainly there should be an effort to address those problems.

I yield at this point to the gentleman from New York, Mr. Lent.

Mr. LENT. Thank you very much, Mr. Chairman. I want to commend you, Mr. Chairman, for calling this hearing. There is no doubt that the insurance industry performs a vital function to our Nation by enabling businesses, both large and small, to plan for and manage the risks associated with doing business.

I am most concerned when I hear that the insurance industry is unable or unwilling to perform this function. I can understand the reluctance of a person to provide day care in the home or nurse-midwives to perform their important function, or of city officials and employees to stay on the job if in doing so they must risk all of their assets in the event of lawsuits arising out of their jobs.

Clearly, insurance is important to all of us, and I think that this hearing will provide us with a good start at exploring the reasons for insurors' unwillingness to write certain lines of insurance.

I look forward to the exchange of views on this issue, one that is so vital to the continuation of everyone's ability to do business.

Mr. FLORIO. Thank you very much.

We are now pleased to have as our first witnesses two distinguished Members of the Congress, the Honorable George Miller, a Member from California, as well as the Honorable Ron deLugo, delegate from the U.S. Virgin Islands.

I would ask both to kindly come forward.

As with all of our witnesses today, their formal statements will be made a part of the record in their entirety, and the witnesses may feel free to proceed as they see fit.

Congressman Miller.

STATEMENTS OF HON. GEORGE MILLER, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF CALIFORNIA; AND HON. RON deLUGO, A DELEGATE IN CONGRESS FROM THE VIRGIN ISLANDS

Mr. MILLER. Thank you, Mr. Chairman, and thank you and the other members of the committee for making this hearing available to us. I welcome the involvement of your subcommittee and, hopefully, the full committee in this issue of liability insurance coverage.

I would like to take a few minutes to outline what our Select Committee on Children, Youth and Families has learned in the hearings which it has conducted.

As you know, last year the House Select Committee on Children, Youth and Family spent a year looking into the issue of child care in America, and I must tell you that we found a system that was woefully inadequate to meet the needs of working parents in this country for the safe protection and care of their children during their working hours.

We found that the only way that we will ever be able to meet the need for child care is with the full participation by all facets of our society. But now what we find in recent months is the alarming reports that the child care operations, family day care home provid-

ers and Head Start programs across the Nation, in their efforts to meet the child care needs of this Nation, are in jeopardy.

With little or no advance warning, the liability insurance for child care providers is subject to midterm cancellation, nonrenewal, severely restricted coverage and dramatic rate hikes, ranging from 200 to 1,000 percent. It is not an exaggeration to say that, as a result of these events, child care could be approaching a major crisis.

As a result of our recent hearings on this issue, we have learned a great deal, and I would like to share some of those findings with you.

Family day care providers in nearly every State, who care for an estimated two-thirds of the Nation's children in child care, cannot find liability insurance. Their homeowner's policies have been cancelled or they have been offered insurance at premiums that equal or exceed their average salary for 1 month.

Well-established youth serving agencies such as the YWCA and Campfire face increases in premiums that range from 300 to 500 percent or more, threatening their ability to provide child care services or other youth programs.

The National Association for the Education of Young Children, which represents 47,000 individuals who work in all facets of early education, told the committee that the loss of insurance and the prohibitive rate increases bear no relationship to the professionalism, quality or claims history of the affected programs. Most programs suffering dramatic changes in their liability coverage have never filed a single claim.

Insurers are concerned about the long tail of exposure that occurs when insuring children because insurers may be responsible for loss litigated many years after the policy is purchased.

Insurers are also expressing hysteria over a perceived threat of child sexual abuse that has received so much media attention of late, but the Select Committee also learned that only an estimated one to one-and-a-half percent of the reported perpetrators of child sexual abuse are child care employees.

In addition, one insurance industry representative who researched the problem could not find a single award for child abuse claims that had been made by any of their affiliated companies. In fact, what became quite apparent from the insurance industry's testimony was that poor financial management, cash flow underwriting to generate dollars for investment purposes, and the historical cycle of highs and lows in the industry were the reasons for the sudden change in policy.

There was general agreement among the insurance industry representatives testifying that losses from child care were comparable to aggregate general liability losses and did not warrant abandonment of the child care market. It appears as if the child care community, which provides one of the most valuable and necessary services for American families, has been held accountable in large part for poor financial decisions made by the insurance industry and has been put in the position, along with other affected businesses, of making up for the insurance industry losses.

This is simply an unacceptable situation. The Select Committee has continued to monitor the situation to determine to what extent

the problem is growing. Representatives of the child care community have informed us that phone calls from concerned child care providers have not abated. In fact, the problem is spreading to foster care, to children's museums and even to public schools.

A recent nationwide survey conducted by the American Public Welfare Association revealed that in 36 States, rates are increasing for all categories of child care providers, and in 36 States, insurance companies are reported to have cancelled policies. Most alarming, nine States responded that child care providers within their States have ceased operation because of the lack of liability insurance.

Federally supported Head Start Programs are not immune from the insurance crisis. A nationwide survey found that, in August of this year, 80 Head Start Programs experienced substantial rate increases, midterm cancellations or nonrenewals of their insurance policies.

Since September 1, increasing numbers of Head Start Programs are reporting cancellations or threefold to tenfold rate increases. Head Start Programs are closing or drastically altering the quality of their programs because they cannot pass the costs on to low-income families that they serve.

In 12 States, State migrant Head Start directors have reported 100 to 400 percent increases in their premiums for liability insurance. One migrant Head Start director in Idaho fears that he will have to close all programs in the State 1 week early in order to meet his $21,000 yearly rate increase for insurance.

As a result, 400 migrant children will accompany their parents to the fields where they work because they lack other alternatives.

We also explored solutions. The Select Committee conducted a survey of State insurance commissioners in States where problems for child care providers have been documented to determine what actions, if any, had been taken to correct the problem.

The responses to these questions yielded little hopeful information. In some States which don't already prohibit midterm cancellation, insurance commissioners have issued bulletins warning that midterm cancellations without justification will be investigated under the State's Unfair Trade Practices Act or have actually issued temporary administrative rulings to prohibit midterm cancellations.

Such action is temporary, at best, but does not address the problems of affordability or nonrenewal without cause.

In Maryland and California, the insurance commissioners are working to establish market assistance plans to promote the insurance industry's voluntary solution to this problem. Other States are considering similar actions.

At the close of last week, the California Legislature approved and sent to the Governor a bill that would protect homeowners' policies for policyholders who also run child care businesses and would require better reporting by insurance companies on the risk experience of the child care centers and family day care providers.

Let me say, however, that while this bill remedies some of the problems, it does not go far enough to insure that liability coverage will be available and affordable.

In addition, negotiations currently under way between the child care community and the insurance industry to seek a longer term solution are headed toward a successful outcome, and even if solutions are forthcoming, the unpredictable nature of the insurance industry leaves open the possibility that this again could happen at any time with little required accountability by the industry.

In addition, the child care industry has undeservedly been labeled high risk. Contrary to the impression created by adverse publicity, it is well known that child care relieves family stress and isolation and that it is an important abuse prevention tool.

While working diligently to safeguard child care services, we must also work to reverse the damage that has been done to this important community of service providers and to strengthen and expand the child care for the millions of American families who depend upon it.

I thank you for the opportunity to testify before the committee.

[Mr. Miller's prepared statement follows:]

TESTIMONY OF GEORGE MILLER

Thank you for the opportunity to address this distinguished panel on the issue of the crisis in liability insurance coverage for child providers. I want to commend the Chairman for his foresight in recognizing the urgency of the situation and the vitally important role that child care plays in the lives of American families.

I am here today to talk about a serious problem that is affecting child care providers nationwide—the loss of reasonably priced, adequate liability insurance coverage that threatens to very existence of reliable and safe child care.

Representatives from the child care community are actively negotiating with the insurance industry and they report that they are close to finding a satisfactory solution. I sincerely hope that they will come to an acceptable agreement. Nevertheless, for child care providers across the country the problem has not abated. And it is spreading to foster parents, public schools and others. For a number of reasons I will highlight, we must all continue to take this issue seriously.

The Select Committee on Children, Youth, and Families, which I am privileged to chair, conducted a year-long investigation of child care. The findings are noteworthy. More women than ever before have entered the workforce and continue to do so at astronomical rates, the population of children under age six is growing dramatically during this decade, and a variety of child care options must be available to meet the diverse needs of American families. The result is an escalating demand for child care services.

The Select Committee learned, however, that the supply of reasonably priced, reliable and accessible child care is woefully inadequate. These findings led the Select Committee to issue recommendations that were agreed to by every member—Republican and Democrat alike—that efforts are needed to expand and improve the existing supply of child care.

In recent months, however, the Select Committee has received alarming reports from child care center operators, family day care home providers, and Head Start programs across the nation that their efforts to provide reliable child care and child development programs are in jeopardy. With little or no advance warning, liability insurance for child care providers is subject to mid-term cancellations, nonrenewals, severely restricted coverage, and dramatic rate hikes ranging from 200% to 1000%. It is not an exaggeration to say that, as a result of these events, child care could be approaching a major crisis.

Given what we know about the already limited supply of reliable and safe child care, the Select Committee took action to help move toward a timely solution to the current impasse. We held two hearings in July 1985, to lay out for Congress the full extent of the problem, and the Justification, if any, for the insurance industry's actions.

In the Committee's tradition, we sought testimony from those who experienced the problem directly, the child care providers, and from those in the insurance industry who have been involved in those policy changes. The Committee was also privileged to hear from my colleague, the esteemed Chairman of this Committee,

who expertise in the area of insurance regulation contributed greatly to the Select Committee's findings.

We learned a great deal from those hearings and I would like to share the findings with you.

Family day care providers in nearly every state, who care for an estimated two-thirds of the nation's children in child care, cannot find liability insurance, their homeowner's policies have been cancelled, or they have been offered insurance at premiums that equal or exceed their average salary for one month.

Well-established youth serving agencies Such as the YWCA and CAMP FIRE, face increases in premiums that range from 300% to 500% or more, threatening their ability to provide child care services or other youth programs.

The National Association for the Education of Young Children, which represents 47,000 individuals who work in all facets of early education, told the Committee that the loss of insurance and the prohibitive rate increases bear no relation to the professionalism, quality, or claims history of the affected program. Most programs suffering drastic changes in their liability coverage never filed a single claim

Insurers are concerned about the long tail of exposure that occurs when insuring children, because insurers may be responsible for a loss litigated many years after the policy is purchased.

Insurers are also expressing hysteria over the perceived threat of child sexual abuse that has received so much media attention of late. But the Select Committee also learned that only an estimated 1% to 1.5% of the reported perpetrators of child sexual abuse are child care employees. In addition, one insurance industry representative who researched the problem could not find a single award for a child abuse claim that had been made by any of their affiliate companies.

In fact, what became quite apparent from the insurance industry's testimony was that poor financial management, cash-flow underwriting to generate dollars for investment purposes, and an historical cycle of highs and lows in the industry were the reasons for the sudden changes in policy. There was general agreement among the insurance industry representatives testifying that losses from child care were comparable to aggregate general liability losses and did not warrant abandonment of the child care market.

Bob Hunter, a witness at this hearing, also testified before the Select Committee. Hunter is a consumer spokesman, as well as an actuary. He said that the current problems in the insurance industry are self-inflicted. He analyzed the actuarial data supplied to the Select Committee for day nurseries and suggested that at most, a 50% rate increase for child care providers might be warranted.

It appears as if the child care community, which provides one of the most valuable and necessary services for American families, is being held accountable, in large part, for poor financial decisions made by the insurance industry, and has been put in the position, along with other affected businesses, of making up for the insurance industry's losses. This situation is unacceptable.

The Select Committee has continued to monitor the situation to determine to what extent the problem is growing. Representatives from the child care community have informed us that phone calls from concerned child care providers have not abated. In fact, the problem is spreading—to foster care, children's museums, and even public schools.

A recent nationwide survey conducted by the American Public Welfare Association revealed that in 36 states rates are increasing for all categories of child care providers, and in 36 states insureance companies are reported to have cancelled policies. Most alarming, nine states responded that child care providers within their states have ceased operations because of the lack of liability insurance.

Federally-supported Head Start programs are not immune from the insurance crisis. A nationwide survey found that, in August of this year, 80 Head Start programs experienced substanital rate increases, mid-term cancellations, or non-renewals of their insurance policies. Since September 1, increasing numbers of Head Start programs are reporting cancellations, or three to ten-fold rate increases. Head Start programs are closing or drastically altering the quality of their programs because they cannot pass the cost on to the low-income families they serve.

In 12 states, state migrant Head Start directors have reported 100% to 400% increases in premiums for liability insurance. One migrant Head Start director in Idaho fears that he will have to close all programs in the state one week early in order to meet his $21,000 yearly rate increase for insurance. As a result, 400 migrant children will accompany their parents to the fields where they work for lack of another alternative.

We've also explored solutions. The Select Committee conducted a survey of state insurance commissioners, in states where problems for child care providers had

been documented, to determine what actions, if any, had been taken to correct the problem.

The responses to these questions yielded little hopeful information. In some states which don't already prohibit mid-term cancellations, insurance commissioners have issued bulletins warning that mid-term cancellations without justification will be investigated under the state's Unfair Trade Practices Act, of they have actually issued temporary administrative rulings to prohibit mid-term cancellations. Such action is temporary at best, and does not address the problems of affordability or nonrenewal without cause.

In Maryland and California, the insurance commissioners are working to establish Market Assistance Plans that promote the insurance industry's voluntary solution to the problem. Other states are considering similar action.

At the close of last week, the California legislature approved and sent to the Governor a bill that would protect homeowner's policies for policy holders who also run a child care business and require better reporting by insurance companies on the risk experience of child care centers and family day care providers. Let me say, however, that while this bill remedies some of the problems, it does not go far enough to ensure that liability coverage will be available and affordable.

In addition, negotiations currently underway between the child care community and the insurance industry to seek a longer-term solution are headed toward a successful outcome.

In addition, negotiations currently underway between the child care community and the insurance industry to seek a longer-term solution are headed toward a successful outcome.

Even if solutions are forthcoming. The unpredictable nature of the industry leaves open the possibility that this could happen again, at any time, with little required accountability by the industry.

In addition, the child care industry has undeservedly been labelled "high risk." contrary to the impression created by the adverse publicity. It is well known that child care relieves family stress and isolation and is an important abuse prevention tool.

While working diligently to safeguard existing child care services, we must also work to reverse the damage that has been done to this important community of service providers, and strengthen and expand child care for the millions of American families who depend on it.

Mr FLORIO. Thank you very much.

Mr. deLugo.

STATEMENT OF HON. RON deLUGO

Mr. DELUGO. Thank you very much, Mr. Chairman.

Before going into my oral testimony, let me say I feel very much at home today because you have a Virgin Islander sitting next to you there on your staff, Mora McLain, one of my constituents from St. Thomas, Virgin Islands; and her mother a good friend of mine of long acquaintance, Vera McLain, is here today. Obviously, we are very proud.

My principal reason for coming before you today, Mr. Chairman, is to commend you and this committee for your willingness to examine the insurance crisis in our country. We in the U.S. Virgin Islands share the awareness reflected by this hearing that the cost of business and to individuals of insuring against all kinds of hazards is becoming increasingly prohibitive.

This hearing also responds to recognition that for some risks and in some parts of the country, including the U.S. Virgin Islands, the problem is even more basic. Some kinds of insurance are becoming almost impossible to get at any price.

In my district, the U.S. Virgin Islands, we are faced with the same skyrocketing rates for automobiles, fire and other types of hazard insurance, but in our case the problems are compounded by the fact that average incomes are lower than on the mainland, and

consequently, higher rates become the equivalent of denial of coverage at a much lower level than would be the case in a community with greater resources.

Many individuals are faced with the prospect of not being able to obtain coverage at all at any price. The problem is affecting businesses as well. I read with sympathy, Mr. Chairman, of the problem truckers have of hazardous wastes in your State of New Jersey, the problem that they are facing in affording, if they can find it, the required liability insurance.

The impact of this problem in the U.S. Virgin Islands was brought graphically to my attention by Mr. Cosmos Williams, the president of the St. Croix Chamber of Commerce. I recognize that we are not alone in this situation but our insurance problems are compounded by the fact that we are a relatively small market, and we are finding it increasingly difficult to persuade insurers to remain active in the Virgin Islands until ways are found to bring greater stability to the situation.

Many insurance companies have either dramatically pulled back on the extent of their participation or simply pulled out of my district altogether. Clearly, the success of this committee's efforts would have great significance for my district, and I will look forward to reviewing the testimony of your committee that you will be receiving from the industry and from its market, and in sharing your findings with my constituents.

Again, I want to thank you for tackling these issues, and commend you for accepting this challenge.

[Mr. deLguo's prepared statement follows:]

STATEMENT OF HON. RON DELUGO

Mr. Chairman, my principal reason for coming before you today is to commend you and this committee for its willingness to examine the insurance crisis in our country. We in the U.S. Virgin Islands share the awareness reflected by this hearing that the cost to businesses and to individuals of insuring against all kinds of hazards is becoming increasingly prohibitive. This hearing also responds to recognition that for some risks and in some parts of the country, including the U.S. Virgin Islands, the problem is even more basic; some kinds of insurance are becoming almost impossible to obtain at any price.

The committee is especially to be commended because the issues involved are complex and solutions will be problematic, hard to define and even more difficult to translate into Federal legislation or recommendations for other Federal action.

Every Member of Congress is aware, however, of the board extent of the problem, particularly in obtaining property and casualty insurance. In my district, the U.S. Virgin Islands, we are faced with the same skyrocketing rates for automobiles, fire, and other types of hazard insurance. But in our case, the problems are compounded by the fact that average incomes are lower than on the mainland. Consequently higher rates become the equivalent of denial or coverage at a much lower level than would the case where the community has greater resources. Many individuals are faced with the prospect of not being able to obtain coverage at all, at any price.

The problem is affecting businesses as well. I read with sympathy, Mr. Chairman, the problem that truckers of hazardous waste in your State are facing in affording, if they can find it, the required liability insurance. The impact of this problem in the Virgin Islands was brought graphically to my attention by Mr. Cosmos Williams, the President of the St. Croix Chamber of Commerce.

I recognize that we are not alone in this situation. But, our insurance problems are compounded by the fact that we are relatively small market, and we are finding it increasingly difficult to persuade insurers to remain active in the Virgin Islands until ways are found to bring greater stability to the situation. Many insurance companies have either dramatically pulled back on the extent on their participation, or pulled out altogether. I have written personally to the chief officer of the insurance companies operating in the Virgin Islands urging that they give careful

consideration and exercise more forebearance in reacting to the problems of the Virgin Islands market.

What is perhaps the most disturbing aspect of the insurance crisis nationwide is the complexity of the situation. Even industry experts have conflicting opinions as to the genesis of the problem. State and local governments have enacted a wide variety of insurance regulations and 'no fault' laws, that according to a recent U.S. Department of Transportation study, have met with widely varying degreees of success. The inconsistency of the results raises more questions. What is clear is that we need hard, cold facts.

Clearly the success of this committee's efforts would have great significance for the Virgin Islands. I will look forward to reviewing the testimony your committee will receive from both the industry and its market, and in sharing your findings with my constituents. Again, we thank you for tackling these issues and commend you for accepting this challenge.

Mr. FLORIO. Thank you very much.

Mr. deLugo, just let me ask: What is the rationale that is put forward for the withdrawal from the automobile insurance coverage area in the Virgin Islands?

Mr. DELUGO. Well, they are claiming that the awards that are being made in the courts, that their liabilities are simply too great—that is the excuse, anyway—and that it is not profitable for them to operate in the Virgin Islands anymore. I question that.

Mr. FLORIO. What is the safety record? DOT keeps records. I don't know if they keep records with regard to the Virgin Islands. My point is, for example, in my own State, where we have the highest insurance rates in the country, we also have the best safety record per mile in the country. I am just wondering if the safety problem, number of accidents per capita, is something that is particularly extraordinary.

Mr. DELUGO. No. I think our safety record would be average and would compare favorably with most of the States, but the awards that have been given, the companies contend that the awards have simply been out of line and that they are consistent. Studies that we have done don't bear that out.

Mr. FLORIO. Mr. Miller, let me first of all pay tribute to you and your committee for all of the good work you are doing on all of the problems involving children, and certainly your role. I was pleased to testify at your hearing on the unavailability of insurance for day care centers, and the impact that will have on the whole concept of day care.

Can you give us any up-to-the-minute report on the negotiations that we understand are going forward with Marsh & McLennan Broker to provide for coverage?

Mr. MILLER. I think most of the parties that we have been in contact with, Mr. Chairman, believe that they are going to be successful. I believe there is another meeting on Monday, which we hope is the final meeting at which they will reach an agreement to provide a means by which, once again, liability insurance will be extended back to the day care providers; but I don't want to speculate on or characterize those negotiations other than to say that it is the most hopeful thing that we have on the horizon.

Whether or not those particular negotiations in and of themselves will be able to address what appears to be a spreading problem to other areas of providers of human services, I don't know; but I think it, hopefully, will provide a blueprint to the rest of the insurance industry to see that in fact this coverage can be provided

to child care provides and that they clearly are within the bounds of insurability without the kinds of unnecessary cancellations that we have seen or, in some cases, the extraordinary, extraordinary rate increases that have gone out through the entire human service area.

Mr. FLORIO. It is our understanding from the information we have that the claims experience in day care centers has been rather good. There haven't been a whole lot of claims. Some of the industry justified the increases and the cancellations on their apprehension about potential claims growing out of instances of child abuse.

That appears to be anticipatory or speculative, and if that is the case, some suggestions have been made and will be made here today about a Federal reinsurance program approach to deal specifically with offshoots of potential liability. That is Federal reinsurance to deal with child abuse claims, as an example, out of day care centers.

That, of course, would relieve the insurance industry in some respects from the potential problems associated with extraordinary claims. On the other hand, if their concerns are not founded, it certainly would provide for their ability to come forward and the Federal Government Reinsurance Program would not become involved, but at least it would take away the reason for people retreating from coverage, or if there is a legitimate concern, it would insulate the private sector from those extraordinary concerns which may not be able to be anticipated in costing out their risk analysis process.

Have you given any thought or has your committee given any thought to the concept of Federal reinsurance programs for extraordinary aspects of the overall risk potential growing out of day care centers?

Mr. MILLER. I would welcome it because without that kind of effort, unless there is a major breakthrough within the industry, we are held captive to their speculation, whether or not that speculation is well founded. And again, the historical evidence suggests that these kinds of claims have not come out of the child care industry.

Again, we heard from the National Child Abuse Coalition and others that simply this is not the setting in which most child abuse takes place, and I think that we are told that because of the underlying tort system and the possibility of what the law entails in these events, that therefore the insurance industry is correct in its conclusion to its speculative evidence.

I think we ought to remove that speculation. I think reinsurance is one of the ways in which the Federal Government can do it, and when we look very often at how does the Federal Government support some of these human services, that may be one of the keys.

Until we have such time to experience whether or not the speculation that is now being promoted by the insurance industry is, in fact, accurate, I don't happen to believe that it is. I think it sells all too short the people who are providing family home child care and day care centers and the YMCA, YWCA and others. It just sells them too short, and I think that if that is going to continue to be

the basis for their rejection of coverage, then we ought to step in and propose some kind of reinsurance event.

Mr. FLORIO. Thank you very much.

Mr. Lent.

Mr. LENT. Thank you, Mr. Chairman.

I am sure it is no comfort to our witnesses, both of whom I want to thank for their appearance here and their contribution to this committee hearing, but it is probably no consolation to know that later today, we will be hearing from an entire bevy of people who for one reason or another are finding difficulty obtaining insurance at what they feel to be a reasonable price, and I think perhaps our committee is going to have to look a little deeper than just the surface problems to try to find out what really may be a crisis in the whole tort liability judicial system.

We are going to hear and we are hearing from not only child care operators but also gasoline station operators and hospitals and motor carriers, nurse-midwives, housing authorities, municipalities who are finding it increasingly difficult to obtain insurance at a reasonable cost.

Of course, when we look at insurance, we have to look at the basic concepts underlying insurability and insurance contracts, and that is the concept of risk. Risk means literally the chance of loss or the probability of a loss. If a loss is certain to happen, there is no risk or loss to transfer, and an insurance transaction cannot take place.

There is a growing perception among underwriters that the accumulation of legal remedies provided under State and Federal liability systems are changing a hitherto insurable probability of loss to an uninsurable virtual certainty.

The second fundamental of underwriting and insurance is that of predictability. If there is no way to predict, then of course they can't write.

I would like to ask whether—and you note that no claims have been made for child abuse in day care centers, but isn't it a fact that in most of these States, that the statute of limitations exists, which does not begin to run with respect to infants until they obtain the age of majority in that State.

So that the fact is there is a latent possibility that might go on for as much as two decades of a claim being made on behalf of or by an infant.

Mr. MILLER. There is no question about that. I think that clearly that is a reason for concern and must be factored into the premium and the risk that the insurance company is willing to accept, and the tail, as they call it, the long tail here has to be of concern to you when your exposure may run for a period of 18 to 20 years.

But let me just say something. You know, I think this subcommittee has a rare opportunity to look at both the insurance aspect and the tort liability aspects that are concerning people; but let us just keep something in mind. I may be a little cynical, but I hope that these cancellations and these rate increases are not part of a clever scheme to whip up a constituency—almost an hysterical constituency, which then decides that we must have immediate, rapid changes in our tort liability system.

In the past we have had these issues confronted at the State level, and at the Federal level because all of a sudden all of the doctors' malpractice insurance is canceled or the attorneys' malpractice insurance is canceled. Here we have day care. Here we have a whole cross-section of America that has been cancelled. We don't know yet whether that was justified or not based upon the insurance aspects of this industry.

We also know there is another agenda going on here with the insurance companies, which is to suggest that we have to have a wholesale reform of the tort system. There are many changes that we may have to have in the tort system, but we ought to make clear what the atmosphere is and whether the atmosphere is one of real crisis or manufactured crises, and I will leave that to the insurance industry to discuss.

But I am a little concerned when I see a huge public relations job going on for tort reform and at the same time I see middle Americans, whether in the service industry, whether they are truckdrivers, gas station owners or child care providers, having their liability insurance taken away from them. I think there is a connection between those two which ends up saying: Write your Congressman.

I would just hope that you separate those two issues because I think, Mr. Lent, the question you asked about what is the impact of the long tail and what kind of liability does that mean for an insurance company, clearly that must be considered. I don't know whether you can shorten that tail with respect to the provider of child care services or the YWCA or whether that is even proper, but I would just hope that those questions would be considered in one atmosphere, and this fire storm that is being created on the other side to put pressure on State legislators and the Congress to go for some kind of wholesale tort reform to limit the liability and the exposure of people and the rights of others be considered in another atmosphere.

I think there are two things going on here at the same time.

Mr. Lent. If some of these changes were to be made, it might make it a lot easier for the people that you are working for, the day care center operators, to get some insurance.

Mr. Miller. I said in our earlier hearings where the chairman testified, the question of caps on liability and exemptions and riders to exclude certain activities, I don't have a great deal of a problem with considerations of those kinds by the industry to try to limit their liability and still provide the people who would deliver their child into that setting some reasonable recourse if something goes wrong.

I have no opposition to that; I just want to make sure that it is considered in an atmosphere that accurately portrays the picture. And again, the speculation that all child care centers have mad people running around and abusing the children just does not hold up under the evidence. So now, what is the real risk and what is the experience in this industry?

I think you know that this committee is one of the few bodies that has the opportunity to really ask that question in the entire Federal Government. We have basically ended up with pretty close to a boycott in terms of our hearings in trying to get the industry

to come before us, but I suspect they have a little more fear of this committee and its reputation in terms of its investigative powers.

Mr. LENT. A lot of States have programs to assist those having difficulty obtaining insurance. Do you know whether some of these—I guess it's your constituents or the people that you are talking to on your committee. Have the States been looked to by the day care centers?

Mr. MILLER. Absolutely. We again have stated my first choice would be to have the industry somehow take care of this problem itself, and if not, I think clearly the area for change would come from the State government before the Federal Government.

My own State of California has passed a couple of pieces of legislation, and has a reinsurance pool proposal working at the State level that the legislature has not yet passed. At the same time, the insurance commissioner has suggested and is working with the industry for some kind of voluntary assistance program between companies to share this risk. I think that is true in Maryland and a number of other States. In other States nothing has happened, and that is part of the problem.

Mr. LENT. My final question is: What is it that we are getting at? What do you have in mind, either gentleman, that the Federal Government could do to assist these people beyond what the States may already be doing?

Mr. MILLER. I think one point—first you are going to have to pull apart the problem and see what are the constituents of the problem that are, in fact, real. As the chairman pointed out, the issue of speculating about what huge losses may occur in the future and giving examples of one or two tort cases that therefore suggest that you can no longer provide liability insurance for a totally unrelated field because somebody chopped themselves up with a lawnmower, that it says that you can't provide the YWCA coverage for youth programs, may or may not be related.

I think part of it is your ability as a committee to pull that apart. If it is necessary, if States won't move—let me just tell you, this country cannot survive without a child care industry, and we owe it to parents who are out there working, trying to stay in the workplace many of them low income, we owe it to them to make sure that their children are in a healthy and safe environment. Clearly one of the things that must be required is some kind of insurance so that whatever mishap takes place, a fall or abuse, whatever it is, that they have some recourse.

One of the things that has emerged very clearly in the last decade is that our economy now is very, very dependent upon the ability of people to have care for their children while they are working. They are working out of necessity, and you know what it takes to hold a household together. We have more and more two-income families.

Mr. LENT. Thank you.

Mr. MILLER. Thank you.

Mr. FLORIO. The gentleman from Texas.

Mr. FIELDS. I have no questions, Mr. Chairman.

Mr. FLORIO. Let me express my appreciation to both witnesses. I think the last couple of comments from Mr. Miller are particularly important. We have to find out what the real problems are. If

there are legitimate concerns that the industry has, we should try to address them.

At the same time, we have to be aware of the fact that if there are not legitimate concerns, we cannot allow a sense of hysteria, whether it be in the area of child abuse. In my own State, as an example, there was a lawsuit brought by a parent against a coach of a Little League team, the suggestion made that the Little Leagues couldn't get insurance if this type of thing happened, and the Little Leagues would be gone.

The State legislature passed a law essentially saying that Little League coaches are now unable to be sued, which in a sense is not the most thoughtful approach to the problem if that were put forward. That was put forward as a means of preserving insurance availiability for something we can all identify with, the desirability of having Little Leagues.

So I think there is a need to get at the bottom of what is real and what is not real and to try to do that in a thoughtful way on a national basis. This is not a problem in one area, one segment of our economy, one State. It is across the board, all segments of our economy, in all of our States. The business of risk evaluation is what the insurance industry is all about. If there are extraordinary problems, maybe there is a need for some input at the Federal level.

I had the occasion to go to an insurance company's office in Manhattan a while back, and they were very pleased to convey to me their new line of insurance, which was insuring against the risks of foreign government coups for multinational corporations. I would suggest that if they can assure and assess the risk of the overthrow of a foreign government, there is probably the capability of assessing the risks associated with less esoteric things than the intricacies of foreign government politics.

So I am looking forward to this as the beginning of a series of hearings that will be looking into this very important economic subject that is key to the health of the Nation's economy.

Let me thank you very much for your presentations.

We now will move rapidly to our next panel, which is made up of Mr. Ralph Nader, the director, Center for Study of Responsive Law, and Mr. Robert Hunter, president, National Insurance Consumer Organization.

Gentlemen, we thank you very much for your presentation today. Your statements will be made a part of the entire record. You may proceed in the fashion you see fit.

Mr. Nader, we are pleased to hear from you.

STATEMENTS OF RALPH NADER, DIRECTOR, CENTER FOR STUDY OF RESPONSIVE LAW; AND J. ROBERT HUNTER, PRESIDENT, NATIONAL INSURANCE CONSUMER ORGANIZATION

Mr. Nader. Thank you, Mr. Chairman and members of the subcommittee for the opportunity to testify on the sharp increases in insurance premiums and widespread cancellation.

Consumers of insurance products in America are facing a crisis, not one so much of availability nor one of affordability, but one of confidence. This crisis in confidence lies in whether this Congress

will take the necessary steps at the Federal level to give consumers relief from abusive practices of the insurance industry.

By massively canceling policies or refusing to sell coverage without 300- to 1,000-percent increases for day care centers, nurse-midwives, transit authorities, physicians, municipalities, fishing fleets, asbestos removal firms, to name a few sectors of the economy, the insurance industry is betting that the resultant pressure will lead the States to grant excessive rate increases and changes in policy forms and will lead the State Legislatures and the Congress to enact restrictions on injured people's right to sue.

The insurance industry is gambling for high stakes. If successful, the bet will pay off in billions. If it is not successful, it means there will be an increased expansion of Federal reinsurance activity and increased expansion in self-insurance pooling systems by the afflicted economic sectors.

The insurance industry has won on this bet once before. There seems to be an underwriter's 10-year itch of greed operating here. Ten years ago the companies bellowed about the "medical malpractice and product liability crisis" and got higher premiums from State authorities and favorable changes in the laws against victims' rights in many States.

Subsequent studies, including one by the U.S. Department of Commerce, revealed no such crisis, but the damage was done to consumer rights and their pocketbooks. Insurer profits soared.

Now, 10 years later, we are witnessing what actuary Robert Hunter calls a manufactured crisis intended to bloat insurance profits and reduce victim rights. Already in the first 6 months of 1985, auto insurance premiums have risen 9.1 percent, more than the rate of increases for all of 1984. At this rate, auto rates will rise 18.2 percent this year, far in excess of increases in claims or inflation.

All the elements for a repeat of the 1975 crisis are in place. Even the Congress has fallen into line, at least temporarily. Bills are pending or will be introduced before the House and Senate that would restrict victims' rights and product liability, medical malpractice and admiralty-related suits.

These victims' rights are not just rights to be duly compensated for their injuries. They are also rights to generate through our common law the deterrence that will increase the incentive by manufacturers for greater safety in the future for other people.

It is to be hoped that this "strike 'em or gouge 'em" gamble will backfire. Americans do not like companies which refuse to sell to them or which refuse to sell to them unless they get 3, 5, or 10 times the previous price. Do you know any industry in America, including the oil industry, that tries to increase its prices 3, 5, or 10 times? Tenfold?

I don't know any industry that even dares to do that except the insurance industry. It always considers itself a special case. It is brazenly unique in these quantum price jumps or arbitrary refusals to deal. This kind of abuse turns people off. I am submitting letters for the record from small businesses all over America showing the kind of detailed indignation that they are reflecting in response to 300-, 400-, 1,000 percent increases in premiums, including those businesses who have never had a claim in years.

If the insurance industry is selectively going on strike or abandoning certain markets or imposing wildly extortionist prices, then Federal or even State government pools of insurance can be established to provide insurance to people who lose coverage through no fault of their own.

The Congress could articulate standards by which the States must regulate insurance, and the Department of Justice could investigate and take steps to protect consumers.

It is obvious that insurance is a necessity. It is also obvious that when it is not available, the Government has a role to step in. In the 1960's when those same insurers refused to offer insurance to properties in the center cities, the Federal Government offered FAIR plans that kept insurance available in the cities. The Government made money in this business, contrary to insurance industry prediction.

The Government has offered insurance in the past when private insurers have balked: crop insurance for farmers, bank deposit insurance for savings accounts, crime insurance in the less affluent areas of the country, and for some years, flood insurance for properties on flood plains. Federal law has facilitated self insurance pools for companies which want to get together for coverage in the product liability area.

So the insurance industry is gambling also with the risk of inviting Uncle Sam's intervention and self-insurance by syndicates of their former customers.

Leaders in the industry think they will win. They have won before. John J. Byrne, former head of GEICO Insurance and now the new CEO for the Firemen's Fund, has said, "It is right for the industry to withdraw and let the pressures for reform build in the courts and in the state legislature."

Thomas Green, President of his own reinsurance brokerage firm, has said Lloyds of London would "simply not write reinsurance for the American casualty industry."

Gerald Wakefield, a Lloyds representative, was reported as having wryly said that if new policy forms limiting the insured's right were not approved—presumably they want to bring down the rights of Americans to sue in courts to the lowest British denominator—Lloyds of London would not reinsure American liability insurance.

Now, Lloyds of London has been acting very arrogantly lately. One can understand given the scandals affecting it back in the United Kingdom. But Lloyds' chair, Peter Miller, said later that, "This is not a threat."

The subcommittee would advance the purpose of its inquiry were it to examine the lobbying and pressures on domestic insurers and State regulators and lawmakers by this British giant, Lloyds of London, a major initiator of the domestic insurers' over-reaching. Also a major lobbyist in the infamous Minnesota bill restricting the rights of victims to recover for toxic wastes that passed in Minnesota this year.

Instead of this massive industry using its economic leverage for claims prevention by advancing pollution control and cleanup, safer consumer products and workplaces, instead of using its lever-

age for loss prevention, for which it has a great leverage, it is using its leverage to reduce victims' rights and gouge consumers.

It is interesting that when Lloyds of London started several centuries ago, Mr. Chairman, in insuring the commercial ships that went on the India trade around the Horn in Africa, it required these ships to have lifeboats and it also took the lead in establishing lighthouses to alert ships that might be getting too close to the rocks.

In short, it was interested in loss prevention. It was interested in safety. The insurance industry has got to pay more attention to that as some companies have in furthering air bags in cars.

For example, Engineering Times reports that the main underwriters for the 11,000 architectural engineering firms will include a pollution exclusion in all future policies. Think what this means. In your States, these architectural engineering firms working on municipal treatment plants or projects involving emissions or recycling or asbestos removal from schools, a big issue in New Jersey, or reconditioning or reclaiming waste products won't have insurance for these activities.

So this is not just an economic crisis; this is an impact on the health and safety of the American people proceeding from this 10-year strategy of the insurance industry.

Other policy changes would include the cost of defending suits within the limit of liability in a policy. This means if a buyer has a million dollars of coverage and the insurance defense lawyers spend $1 million defending the suit—and they have been known to bill very abundantly—nothing remains for any victim recovery.

The insurance companies are using judges and juries as their favorite whipping boys, blaming verdicts, and settlements for their troubles. Their favorite figure to bandy about, which you will hear later today, is that they lost $3.5 billion last year.

I would urge the subcommittee to hold the insurance industry to its presumed pride, that is, of being a data generator, and require them to prove their case in numbers. Instead of a $3.8 billion in losses last year, a U.S. General Accounting Office report on insurer profitability shows a $300 million profit over underwriting losses last year for the property/casualty insurance industry.

The key question is: How much did you gain or how much did you lose, insurance company, when you combine insurance investment income with premium revenue? If insurers are losing so much money, Mr. Chairman, why are their stocks selling at record prices on the stock exchange? A.M. Best's Insurance Index shows an increase of 30 percent for property/casualty stocks in the first 6 months of 1985. The S&P Industrials languished at a mere 14 percent, and the Dow Jones industrials at a paltry 10 percent for the same first 6 months of 1985.

If insurers are losing so much money, why are stockbrokers recommending that these companies are such great buys? The brokers know that the industry will continue to be as profitable as it has been over the last 10 years, where, according to the GAO, investment income has exceeded underwriting losses by $72.1 billion, not to mention their tax refund.

It will take an informed citizenry and an informed media to stop the Great Insurance Industry Boycott of 1985. This hearing is an

important first step toward providing the essential information. The insurance industry must be required to support its assertions of losses with data unencumbered by accounting flim-flam.

During the phony product liability crisis in the mid-seventies, I would repeatly ask this industry to provide us with data as to how much was paid out in verdicts and settlements compared to how much it took in in product liability premiums. It always demurred.

I hope this is only the first of a series of hearings on the insurance crisis, so called, and that perhaps regional hearings might be held to give all of America the opportunity to see that the crisis should not be manufactured but rather that they should see a renewed dedication by Congress to the protection of all consumers.

The letters which we have received and which you will soon receive, I am sure, in even greater numbers show that small businesses minding their own business, with very little loss claim experience generated to their insurer, are experiencing increases.

Mountain Brook Cottages, a rental cottage firm in Sylva, NC, went from $1,800 a year to $11,000 a year.

The Copitz Co. in Decatur, IL, a plate fabricator, went from $11,736 in 1989 to $61,317 in premiums in 1985. They have never had a single claim on their liability insurance coverage.

The Carolina Fire Equipment Co., Greenville, SC, never had a liability claim paid over 20 years or more. Now they are having their insurance canceled or they are exposed to a spectacular premium increase.

A Boat Transport firm in Gainesville, GA. The rates were $850 per year with the Reliance Co. Now the best they can do is quotes from other companies for $3,500 to $5,500 a year.

And finally, Public Housing Authorities. What is the conceivable reason for this kind of dramatic increase? In Albany, NY, best bids call for 1,000 percent increases at an extra cost to the Public Housing Authority of $200,000. You will hear more testimony on that later.

In short, if there is a problem, we want to see the data, and if the data is verifiable, adjustments can be made, but not the kind of massive boycotts and strikes and cancellations that stampede ladies and gentlemen such as yourselves in Congress and the State legislators into rolling back 100 years of civilized progress in the provision of personal injury rights to victims and their next of kin, and draining off even more than 12 cents out of every consumer dollar now devoted to insurance premiums into the coffers of the insurance industry.

I caution the insurance industry that they are taking a gamble that might lead to a restructuring of their industry, with people going into this industry in self-insurance syndicates backed by Federal reinsurance. That is the gamble that the insurance industry is taking now. But in the meantime, many people, individuals and businesses, are suffering.

Thank you.

[Testimony resumes on p. 37.]

[The prepared statement of Mr. Nader and submitted letters follow:]

STATEMENT OF

RALPH NADER

Good morning. Mr. Chairman, members of the subcommittee, thank you for the opportunity to testify on the sharp increases in insurance premiums and widespread cancellations.

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The insurance industry has won on this bet once before. There seems to be an underwriters' 10-year itch of greed operating here. Ten years ago, the companies bellowed about the "medical malpractice and product liability crises" and got higher premiums from state authorities and favorable changes in the laws in many states. Subsequent studies, including one by the U.S. Department of Commerce, revealed no such crises but the damage was done to consumers' rights and their pocketbooks. 1/ Insurer profits soared.

Now, 10 years later, we are witnessing what actuary Robert Hunter calls "a manufactured crisis intended to bloat insurer profits and reduce victims' rights." Already, in the first six months of 1985, auto insurance premiums have risen 9.1 percent, more than the rate of increase for all of 1984. 2/ At this rate, auto rates will rise 18.2 percent this year, far in excess of increases in claims or inflation. All the elements for a repeat of the 1975 "crises" are in place. Even the Congress has fallen into line. Bills are pending or will be introduced before the House and Senate that would restrict victims' rights in product liability, medical malpractice and admiralty related suits.

It is to be hoped that this "strike 'em or gouge 'em" gamble will backfire. Americans do not like companies which refuse to sell to them, or which refuse to sell to them unless they get three or five or ten times the previous price. The insurance industry is brazenly unique in these quantum price

jumps or arbitrary refusals to deal This kind of abuse turns people off. If the insurance industry is selectively going on strike, or abandoning certain markets or imposing wildly extortionate prices, then federal or even state government pools of insurance can be established to provide coverage for people who lose coverage through no fault of their own. The Congress could articulate standards by which the states must regulate insurance. The Department of Justice could investigate and take steps to protect consumers.

Insurance is a necessity and affected businesses cannot be required to close down. Products which are safe and beneficial might be kept from markets. Physicians and surgeons may quit practice because of unavailable or unaffordable insurance. Society cannot function properly when its commerce is so disrupted. When those same insurers refused to offer insurance to properties in the center cities during the disruptions of the '60s, the federal governmment offered the FAIR plans that kept insurance available in the cities. The government made money in this business, contrary to insurance industry predictions.

The government has offered insurance in the past when private insurers have balked ---crop insurance for farmers, bank deposit insurance for savings accounts, crime insurance in the less affluent areas of the country and for some years flood insurance for properties on flood plains. Federal law

has facilitated self-insurance pools for companies which want to get together for coverage in the product liability area. So the insurance industry is gambling also with the risk of inviting Uncle Sam's intervention and self-insurance by syndicates of their former customers.

Leaders in the industry think they will win. They've won before. John J. Byrne formerly head of GEICO Insurance and new CEO of the Fireman's Fund has said; "It is right for the industry to withdraw and let the pressures for reform build in the courts and in the state legislatures." 3/ Thomas A. Greene, president of his own reinsurance brokerage firm, has said Lloyd's would "simply not write reinsurance for the American casualty industry." 4/ Gerald Wakefield , a Lloyd's representative was reported as having wryly said that if new policy forms limiting insureds' rights were not approved, Lloyd's would not reinsure American liability underwriters. 5/ Lloyd's chair Peter Miller said later that: "This is not a threat." 6/ The Subcommittee would advance the purpose of its inquiry were it to examine the lobbying and pressures on domestic insurers and state regulators and lawmakers by this British giant, Lloyds of London -- a major initiator of the domestic insurers' over-reaching.

Instead of this massive industry using its economic leverage for claims prevention by advancing pollution control and clean-up, safer consumer products and workplaces; instead of using its leverage to help stabilize the economy, it is, with

few exceptions, behaving like a spoiled brat. The insurance industry should be more than a cash cow; it should be a safety bull to reduce the basis for claims. This spoiled brat must be weaned of the fruits of its manufactured "crises" and not allowed to increase prices while restricting cover for insureds and the legal rights of victims.

For example, Engineering Times reports that the main underwriters for the 11,000 architectural/engineering firms will include a "pollution exclusion" in all future policies. This means that firms working on municipal treatment plants or projects involving emissions or recycling, reconditioning or reclaiming waste products won't have insurance for these activities. Other policy changes would include the cost of defending suits within the limit of liability in a policy. This means that if a buyer has a million dollars of coverage and the insurer defense lawyers spend a million dollars defending the suit, nothing remains for any victim recovery.

The insurance companies are using judges and juries as their favorite whipping boys, blaming verdicts and settlements for their troubles. Their favorite figure to bandy about is "$3.8 billion in losses last year." A U.S. General Accounting Office (GAO) report on insurer profitability shows a $300 million profit over underwriting losses last year for the property/casualty insurance industry. 7/ If insurers are losing so much money, why are their stocks selling at record prices on the stock exchanges? A.M. Best's Insurance Index

shows an increase of 30% for property/casualty stocks in the first six months of 1985. The S&P Industrials languished at a mere 14% and the Dow Jones Industrials at a paltry 10% for the first six months of 1985. 8/ If insurers are losing so much money, why are stockbrokers recommending that these companies are such great buys? The brokers know that the industry will continue to be as profitable as it has been over the last 10 years where, according to the GAO, investment income has exceeded underwriting losses by $72.1 Billion (and they got a $63 million tax refund)! 9/

It will take an informed citizenry and an informed media to stop the great insurance industry boycott of 1985. This hearing is an important first step toward providing that essential information. The insurance industry must be required to support its assertions of losses with data unencumbered by accounting flimflam. During the phony product liability crisis in the mid-seventies, this industry would not even produce data as to how much was paid out in verdicts and settlements compared to what it took in in product liability premiums. I hope this is only the first of a series of hearings on the insurance "crisis" and that perhaps regional hearings might be held to give all of America the opportunity to see that the crisis need not be manufactured, but rather that they see a renewed dedication by the Congress to the protection of all consumers.

I would like to include for the record some detailed letters

by small businesses who have been abandoned or gouged by insurance companies.

Thank you.

NOTES

1/ Report on Product Liability Ratemaking, Product Liability and Accident Compensation Task Force, US Department of Commerce (1980). At page ix the report criticizes ratemaking as "overly subjective" and rates as being "excessive."

2/ CPI data on "auto insurance," Bureau of Labor Statistics.

3/ Journal of Commerce, p.10A, col.2 (June 18, 1985).

4/ Journal of Commerce, p.10A, col.3 (June 18, 1985).

5/ Journal of Commerce, p.8A, col.1 (July 26, 1985).

6/ Journal of Commerce, p.1A, col.4 (Sept. 4, 1985).

7/ Statement of Natwar Gandhi, Group Director Tax Policy (US GAO), before American Risk and Insurance Association, Aug. 20, 1985, pp.2-3, (hereinafter, GAO Statement). Mr. Gandhi will make available a more detailed analysis of insurer profitability in a more extensive report to be released in the late fall of 1985 by the USGAO.

8/ A.M. Bests's, Insurance Management Reports, as quoted in the Insurance Advocate, p.4 (Sept. 7, 1985).

9/ GAO Statement, p.7.

Rt. 1 Lakeview
Rockmart, Ga.
30153
Aug. 26, 1985

Dear Mr. Nader,

I recently read in the paper that you were asking for an investigation of the insurance industry. We would like you to include the truck insurance companies in the investigation.

My husband is an independent truck driver. Right now, he owns a tri-axle dump truck. He has driven trucks for 30 years, for over 2½ million miles and has never had one ticket or accident.

Last year our total insurance bill was about $2200. This year it jumped to $4300 and if it had been re-newed one day later it would have been $5400 and they say next year it will be even worse.

We cannot stay in business

much larger at this rate. Last year our net income (not counting depreciation) was $8,800 and this year is running about the same.

The insurance companies place the blame on a lot of claims and they say they have to protect themselves.

If this is the case why (according to a friend who is an insurance agent) does it cost our neighboring county only $22,000 a year for liability insurance on its fleet of hundreds of school buses? If they should be sued by parents of children involved in an accident, they stand to be liable for a lot more than my husband would be.

We believe something should be done to correct this situation.

If you can do anything, we would be happy to help in any way.

Thank you.

Sincerely,

Mrs. Carlos Johnson
404-684-8286

MOUNTAIN BROOK COTTAGES
ROUTE 2, BOX 3C1
SYLVA, NC 28779

August 29, 1985

North Carolina Department of Insurance
Consumer Service
P.O. Box 26387
Raleigh, NC 27611

Gentlemen:

We own and operate a cottage rental business in western North Carolina, specifically near Sylva, North Carolina.

Last year, 1984, we carried our commercial insurance "fire & liability" with Stanberry Insurance Agency of Sylva, who underwrote for Reliance Insurance Company of Illinois. Our premiums were approximately $1800 per year for our coverage (from 1982-1985).

I have recently been contacted by Mr. Stanberry and advised that Reliance is no longer writing our type of insurance. As a result, Mr. Stanberry has researched available companies and has found a company which will write our policy for approximately $11,000.

Because this amount represents an increase of over $800, I have attempted to locate another company and or independent that would assist us in this matter, however have not met with much success.

In attempting to gain assistance from governmental agencies in Raleigh by telephone, I was finally referred to our local consumer services located in Asheville. Several attempts to contact a "specialist" in this office have met with negative results and I am now directing this correspondence to your office.

In contacting our Prudential Insurance Agent I find that independent agents and companies are required to file with your office concerning the types of insurance as well as their rate schedules.

In an effort to gain assistance in this matter, I am requesting information from your office concerning agents/companies writing commercial insurance for our type business as well as their quoted rates.

Since I feel that it is rather unethical for insurance companies to radically change their policies without warning to their consumers, and because I find that Mr. Nader in Washington is attempting to start an inquiry into this matter, I am forwarding a copy of this letter to his office.

Respectfully,

Augustus R. McMahon
704-586-4[illegible]

Central Insurance Agency
352 Bloomfield Avenue
Montclair, NJ 07042

08/21/85

Hazel Frank Gluck
Insurance Commissioner
State of New Jersey
201 East State Street
Trenton, NJ 08625

Dear Commissioner,

I am writing to you today to bring to your attention another very serious problem affecting property and casualty insurance brokers in the State of New Jersey.

This particular problem is that it is almost impossible for property and casualty brokers to obtain errors and omissions professional liability insurance; especially brokers that have a large proportion of JUA auto policies in their book of business.

Last year for example; I had an E&O policy with Atlanta International Insurance Co.,this policy afforded professional liability in the amount of $500,000. with a zero deductible for legal defense and a $1,000. deductible for a claim paid.

This policy was not renewed by Atlanta International along with as many as 1500 other brokers.

In trying to place my own liability policy I have learned that there are no markets available offering any coverage at a reasonably affordable premium. As a matter of fact the only coverage offered at all was an excess company that wanted an $6500. premium with a flat deductible of $10,000!!! Of course this is a prohibitive situation for anyone.

What I do find interesting is the fact that if a person is lucky enough to be an gent for a property and casualty insurance company there is no problem getting the necessary coverage.

With all the problems a broker has to contend with today, such as, illegal withholding of commissions by JUA servicing carriers, attempts to lower commissions, moratoriums on appointing new agents and now discriminating against P&C brokers who have too many JUA accounts; regarding professional liability........"I wonder, do you think someone is trying to drive us out of business?,a person couldn't be blamed for thinking this."

Ultimately, the insurance buying public will suffer along with the brokers as lawsuits will prove that the public will have very little recourse against an agency that may be negligent in an errors and omissions claim.

Circumstances today are causing licensed property and casualty brokers to be part of a 2nd class method of purchasing insurance.

"After all, would you feel confident placing your insurance with my agency if you new that your recourse would be limited in the event of an E&O claim against me?"

If you could look into this matter, it would certainly be appreciated by me, my fellow insurance brokers and the public.

Very truly yours,

Alan H. Pfleger
Central Insurance Agency

cc:Buddy Fortunato, Assemblyman (Essex)
Michael Adubato Assemblyman (Essex)
Ralph Nader, National Insurance Consumer Organization
The Bergen Record
The Star Ledger
Peter Shapiro

SOUTHWEST TANK LINERS, Inc.

OFFICE:
664 WEST MAIN ROAD — P.O BOX 731
EL CENTRO, CALIFORNIA 92244
619/352-4832
LICENSE NO A418129

August 22, 1985

National Insurance Consumer Organization
344 Commerce St.
Alexandria, Virginia 23314

Attn: Tim Hogan:

Our small family business is being shut down because of our inability to obtain insurance coverage though our total loss over the past four years has been less than $4,000.00. We have had contact with the California Insurance Commissioner, our attorneys, our local assemblyman, our insurance agency and our insurance carrier. I am enclosing copies of this correspondence or your review.

Last year our liability insurance was $17,000.00. This year, when we finally obtained a tentative quote (not firm - it figured to be closer to $100,000.00), it was $75,000.00. We simply can not pay $75,000.00 - we don't have it to pay. As you will notice, we were informed of the problem at the last minute. Every brokerage agent we spoke to wanted 45 to 90 days to quote.

Our business is a preventative maintenance program by which we interior coat with epoxy any metal tank which might begin to leak if not protected. We do underground gasoline storage tanks, water tanks, sewage tanks, etc. It would seem to me that with all the problems with ground, water, and air pollution that this preventative maintenance is extremely important to environmental protection.

What will actually happen if we can't do the work is that other small businesses will close because they can't afford double-walled tanks and expensive installation which is the only alternative to our procedure. Small businesses will postpone expensive repairs or replacement; leaks will contaminate the ground water shutting down water systems as is the case in New Jersey and elsewhere.

Every time we mention our problem in obtaining liability insurance, we find others who are having similar problems. The difference between others and ourselves is that we had little advance notice.

As of this date we have been unable to secure liability insurance. We are virtually out of business. Can anything be done?

Sincerely,

Anna Sessions

Anna Sessions, Corporate Secretary
Southwest Tank Liners

NYSARHO, inc.

NEW YORK STATE ASSOCIATION OF RENEWAL & HOUSING OFFICIALS, INC.

STATE OFFICE • 100 STATE STREET • ALBANY N Y 12207 • (518

TO: OUR SENATORS AND CONGRESSPEOPLE

RE: LIABILITY INSURANCE FOR HOUSING AUTHORITIES

We face a crisis in the State relative to problems caused by an increase in liability insurance from $7.56 per dwelling unit three years ago to $123.00 per dwelling unit this year. We obtained an extension from the $7.56 carrier to September 23, 1985 and some smaller authorities have been able to find coverage within the $40 - $50 range, but the larger authorities are preparing to dip into their reserves to pay this unbudgeted and unplanned-for increase.

These tremendous increases by the insurance industry are being felt across the board; i.e., municipalities, school districts, transportation authorities, etc., - almost all public and quasi-public bodies are now being made aware of it.

We don't pretend to understand it; nor are we prone to accept the industry's explanations of why 1500% increases are necessary this year. We are, however, prone to suggest that the Congress could find out why these increases are coming into force so suddenly and not over a term of years. Nothing in our knowledge has moved so precipitously. And we can't believe that the think tanks of the multi-billion dollar insurance industry were caught so short that they have to recover in one single bound.

We are troubled and will appreciate your advice.

Very truly yours,

F. Joseph Leone,
Executive Director

FJL:n

c: J. Donald Leahey, President, NYSARHO

DATE: August 28, 1985

Affiliated with the N. Y. Conference of Mayors and Municipal Officials, National Association of Housing and Redevelopment Officials, Middle Atlantic Regional Council (NAHRO) and National Housing Conference

ATTACHMENT A

SAMPLE OF LARGE PHA INSURANCE PROBLEMS

Albany, NY	-	Master policy for all PHAs in state expires August 1st. Best bid calls for 1000% increase at an extra cost to PHA of $200,000.
Baltimore	-	Policies were up for renewal June 30th, fairly optimistic about renewal at reasonable rates.
Boston	-	Master policy for all PHAs in region was cancelled. New policy to increase 280%. Coverage cut in half.
Cambridge	-	Major increases. Public liability up 300%. Fire insurance up 90%.
Cleveland	-	Major increases. General liability went from $200,00 to $449,000 (250%) and property from $177,00 to $755,000 (426%).
Cincinnati	-	Major increases. General liability up from $25,000 in FY 84 to $197,000 in FY 85 (788%).
Dayton	-	Hard getting coverage. Lowest bid for liability is $432,000 up from just $12,000 (3600%).
Jersey City	-	Insurer for all PHAs in New Jersey went bankrupt. General liability to go from $93,000 to $235,000 (253%) and fire/extended coverage from $20,000 to $25,000.
Louisville	-	General liability to increase 300%.
Minneapolis	-	General liability to increase 200%.
Mobile	-	Not a big problem. Extended coverage to increase by just $20,000.
Montgomery County	-	Insurance policies have been cancelled and PHA has not been able to obtain new policies.
Nashville	-	General liability premium up 200%.
New Haven	-	General liability increased from $32,000 to $110,000 (344%); fire to rise dramatically; workman's compensation to remain steady.
New York	-	Excess liability to increase from $213,000 to $1.2 million (563%); umbrella coverage from $22,000 to $85,000 (386%); fire from $649,000 to $1.4 million (216%); self-insurance from $5.5 million to $8.1 million.
Oklahoma City	-	General liability coverage reduced 33%. Premiums increased 300%.
Philadelphia	-	Several policies cancelled. Bids received are up 800%.
Rochester	-	1000% increase. General liability up from $56,000 to $548,000; policy runs out August 1st.
St. Paul	-	10% - 60% increase in premiums, higher deductions.

NY NEIGHBORHOOD
antiARSON CENTER
424 W 33rd St New York NY 10001 (212) 947 7926

September 6, 1985

Ralph Nader
PO Box 19367
Washington DC 20036

Dear Mr. Nader,

I have read in the August 24, 1985 issue of the Insurance Advocate about a study issued by yourself and the National Insurance Consumer Organization in which you charge that the property and casualty insurers have manufactured a liability crisis in order to achieve premium increases. As a non-profit organization that works together with community groups to reduce the rate and scope of fire damage in the city, we are constantly coming up against the brick wall of the insurance industry. Recently we ''d a complete analysis of all insurance coverage of multiple dwellings in NYC. (Owners of such properties are required by law to list their fire and liability company with the city). We are now attempting to approach the companies who insure fire and arson prone buildings in various neighborhoods in order to leverage some improvements to remove this risk. Recent claims by landlords concerning increases in insurance costs have been used to ask for higher rent increases in the city. Increases in rates and losses are used by the companies to avoid any meaningful i· ection and prevention monitoring. I would appreciate receiving a copy of your recent study with NICO and any other documents you or they may have produced that give a REAL analysis about what is happening in the industry and why. I certainly would like to read some alternative to the Insurance Advocate! You once did respond to a request from me in relation to access to the industry's Property Insurance Loss Register. You referred our request to the Freedom of Information Clearinghouse. We are currently in the process of requesting the information from the State Insurance Department; a deputy superintendent just postponed a meeting with us because of an ulcer attack. I guess that line of work gives one ulcers! Anyway, I'm hoping you will be able to respond to the current request as you did to our initial one. Thank you and keep up the good work.

Sincerely yours,
Harriet Cohen
Harriet Cohen
Director

The City of Logan

CITY HALL
DINGESS ST
LOGAN, WEST VIRGINIA 25601

GARY H HYLTON
MAYOR
OFFICE 752-4044

August 31, 1985

Mr. Robert Hunter, President
National Insurance Consumer
Organization
344 Commerce Street
Alexandria, Virginia 22314

Dear Mr. Hunter:

In my opinion, The Charleston Gazette rendered an important service with Ralph Nader's article concerning the appearance of greed among the insurance industry.

Our city, The City of Logan, is being abandoned by the United States Fidelity And Guaranty Company (USF&G) after a relationship exceeding that of thirty (30) years. I believe it's grossly unfair that USF&G should take such action. Especially, since we have a minimal claims history

I, for one, do not subscribe to the "strike 'em or gouge 'em" tactics being employed by the insurers of today. Further, I intend to expose the insurance industry's contrived woes in hopes of putting an end to this unfair squeeze.

Please send me any information that you may have on hand, pertinent to this crucial situation.

Sincerely,

Gary

Gary H. Hylton
Mayor, City of Logan

GHH/rap

Enclosure:

Working Together

July 31, 1985

Mr. Ralph Nader
Study of Responsive Laws
Box 19367
Washington, D. C. 20036

Re: American Casualty Co.
Pol.# CAC 240-21-44,
Apt. Bldg. 6949-51 Sangamon; (CNA Ins.Co.,175 W. Jackson),Insured
Harry & Lela Easley

Dear Mr. Nader:

We need your help. After two fires in our 12 apt. bldg.,through no fault of ours, our fire insurance is to be cancelled Sept.6, 1985. The fires were set, 2-25-84 by a vandal who broke into our basement seeking shelter; 5-3-85 by the visiting psychotic son of a tenant; both perpetrators were apprehended and placed in custody.

We have paid excessively high insurance premiums ($4,053) for 35 years and these are the only claims in that period. Ours is the only multiple dwelling unit in our area with grass, flowers and tenant cultivated vegetable plots. Nine tenants are senior citizens, seven families tenants for more than 20 years.

This cancellation will devastate us. Our savings have been exhausted by gas bills, taxes and insurance. We know your concern for the stable, hard working citizens of our city. We appeal for your intervention in our behalf.

Sincerely yours,

Harry Easley

Harry and Lela Easley
Ages 71 and 69
9021 S. Dante Ave.
Chicago, Il. 60619

P. S. Please let us know if we can make a contribution to your work.

Mr. FLORIO. Thank you very much.
Mr. Hunter.

STATEMENT OF J. ROBERT HUNTER

Mr. HUNTER. Mr. Chairman, I appreciate the opportunity to be here today.

I grew up in an insurance home, Mr. Chairman. I have been 25 years in the business. My father was in the marine insurance business. He used to tell me this was a business of utmost good faith. He would tell me how it would grease the wheels of industry, how it would make loans possible. It is an important, vital business to this Nation.

What is going on here is an insult to that whole, wonderful tradition of insurance in this Nation. And I believe it is not factually generated. It is generated totally within the insurance industry's capacity to handle, and I will tell you why as I go through my testimony.

This business is a major business; in excess of 11 percent of disposable income in the country goes into insurance premiums. It is the fourth leading purchase that Americans make after food, housing, Federal income taxes. And it looks like it will pass Federal income taxes this year and become third by the end of the year.

It is a business that should respond at a time when people are hurt. It should give them benefits. It really should be a business that would attract idealistic young people, because it is the sort of business as it grew up historically, that helps people when they are down.

It brings order out of what seems to be chaos because what is a very risky thing for me, say an automobile accident, when you combine me with a million other people, is not so risky any more. The risk goes down as the numbers go up.

That is what insurance is all about.

This cry that suddenly it is riskiness is bad for the insurance business—without riskiness there is no insurance business. There has to be some risk. Otherwise, if everything is totally predictable, there is no need for it.

You don't need to hear it or see this chart for long. Fishing fleets, fireworks manufacturers, no Fourth of July next year according to the insurance industry. Auto insurers discontinue service in D.C. and so on.

Now it is a very broad-based crisis. The States have begun to respond, but they are not able to handle this problem. Witness the increase in auto insurance premiums already this year.

Auto insurance has gone up at an 18-percent rate, as Mr. Nader testified, this year; 9.1 percent, according to the Bureau of Labor Statistics in the first 6 months. Way, way beyond the statistical justification.

I have looked at the numbers. The States are allowing excessive price increases. There is no question about it. They are not, according to their own statutes, allowed to grant excessive rates, but that is exactly what they are doing. And I think they are doing so because of the fear they have that insurers are going to pull out of their State.

The insurance industry is a cyclical business. Here is a chart of that.

Since 1960 you can see it goes up and down. Sometimes the rates of return, net worth fall below the 5-percent line. Sometimes they go above 20 percent. They should be somewhere currently, of the order probably 13 percent. So, they were short last year on premiums. There is no question about that. They were at about a 3-percent rate of return on their growth last year.

Because of leverage and other things, a 3-percent return on net worth is a shortfall of roughly 5-percent premium. If they had 5 percent more premium income last year they would have had a rate of return net worth of what they needed.

Now a 5-percent premium increase need is not a crisis. That is a relatively minor adjustment. They have made those kinds of adjustments before.

Thinking through these cycles, just going back one cycle, in 1974 and 1975, the insurance industry again dipped below 5-percent return on net worth. When that happened we had a terrible outcry about the tort law and about particularly product liability and medical malpractice insurance.

I was serving as Federal Insurance Administrator at the time and we had two interagency task forces to study those two crises; the product liability and medical malpractice crisis. If you look at those studies you will find—and in my footnotes of my statement—you will find that we concluded that those were panic pricing and panic underwriting, subjective judgments.

Now I don't think it is panic any more. I think they learned from that lesson if it was panic then. I think what is going on currently is not panic, but calculated.

In any event, the Federal studies that were undertaken by the interagency task force concluded the pricing was panic pricing.

I would call your attention to the hearings on the Senate side, Senator Kennedy's Health Committee on Medical Malpractice, where it was clear that ratemaking had run amok. Ratemaking there, the Senator got out of the industry witnesses, had resulted in base rates that were higher than possible. They were predicated upon average claim costs higher than the policy limits.

Mr. LENT. I wonder if I ·ould just ask you a question about that chart, because I am havi little trouble following it.

I think you said an i company should have a return on its net worth of 13 perc

Mr. HUNTER. Or 13 to hat range.

Mr. LENT. Is that what t. chart represents?

Mr. HUNTER. This chart is the total return on net worth.

Mr. LENT. So in 1984 you show the chart going down to less than 3?

Mr. HUNTER. Three percent, roughly.

Mr. LENT. So it is a 3-percent return on net worth?

Mr. HUNTER. So they are roughly 10 points short of what they should have had.

Mr. LENT. You say this is calculated by the insurance industry?

Mr. HUNTER. I say this pullout, this abandonment, I think they are taking advantage of us. This was done by them.

Mr. LENT. You mean they are conspiring to lose money?

Mr. HUNTER. They didn't lose money. They made money. This is a profit.

Mr. LENT. Your chart shows——

Mr. HUNTER. They are not losing money.

Mr. LENT. A company that is only yielding 3 percent on its net worth would seem not to be doing very well.

Mr. HUNTER. They are not. They cut prices significantly.

I will go through the whole cycle and you will understand how they go there.

Mr. LENT. They cut prices?

Mr. HUNTER. Absolutely.

Mr. LENT. I thought you were complaining about higher premiums?

Mr. HUNTER. You have to go through the cycle with me. I will get to that if you will be patient, Mr. Lent.

Following this bottom in 1975, insurers cried for tort reform and significantly raised prices. They found the response of the insurance departments was to, in effect, give them anything they wanted.

One insurance commissioner told me when I was Federal Insurance Administrator, that he had just approved a 150-percent rate increase in medical malpractice. He gave me a copy, I looked at it, I said I'm an actuary, I looked at it, I said you couldn't possibly grant more than, say, 25 percent on this data.

He said you are absolutely right. That is what my actuary said, too.

I said why did you grant a 150-percent rate increase?

He said because the company said we will pull out of the State. There are only one or two writers left. Now how can I say no.

Now that is what went on. And what happened of course, is their rate of return skyrocketed to 22 percent overnight. That is what happened.

Now, at the top and during this decline in profits what happened is this—and this will get to your point Mr. Lent, let me read a quote out of a footnote to my statement, footnote 11. On November 20, 1981, here is a quote from the National Underwriter.

"A large commercial umbrella liability risk * * * "—this is the dreaded liability with all the tort problems—" * * * came up for renewal and was rated at $105,000, about the same as the previous year. But the insured was not satisfied. Aware of the aggressive rate competition in the commercial lines market today * * * "—this was rate competition generally, because a lot of these—these profits were driving a lot of the larger accounts into self-insurance. Because of this competition—" * * * he decided to shop around. He approached a second agent, who submitted the very same risk to a different company, which offered to write it for just $20,000.

But, the insured was still not happy. He continued shopping and eventually the original company, which originally wanted $105,000 came back and took the business for $5,000. That's right, $5,000.

That's what happened right here.

Mr. LENT. Let me——

Mr. HUNTER. This was the dreaded liability insurance that 2 years before was a tort crisis and required all kinds of reform.

Mr. LENT. But for all of the years prior to that small period of time, the return on net worth appears to average about 5 or 6 percent.

Mr. HUNTER. You mean back in this history?

Sure, and that is all it needed. This is a low-risk business.

Mr. LENT. So there was a period there—what are the years?

Mr. HUNTER. It goes from 1960 to 1984.

Mr. LENT. It was above 15 percent during a very small period demonstrated by that chart.

The insurance companies' net return—return on net which was above 15 percent during that—how many years was represented by that chart?

Mr. HUNTER. About 5 years, 6 years, something like that. This period, about 5 years.

Mr. LENT. They were above 15 percent for 5 years, and you show 25 years.

Mr. HUNTER. They didn't need——

Mr. LENT. So, for 5 years out of 25 years they were above 15 percent. But the other 15 years, the other 20 years they were below the 13 to 15 percent, which is what you claim they ought to earn.

Mr. HUNTER. They did not need 15 percent back in 1960. They needed probably 3 or 4 percent.

The rates of return required of this business vary over time. The rates of return of any business go up and down with things like inflation.

Mr. LENT. We all agree that right now—I'm looking at this chart also. We all agree that right now there is an insurance industry——

Mr. HUNTER. Is this coming out of my time, Mr. Chairman?

Mr. FLORIO. Respond to Mr. Lent's question. Then what we will do is ask you to conclude——

Mr. LENT. It is very hard to ask a question, Mr. Chairman, about a chart that is put back into the portfolio. I thought it would be more illuminating——

Mr. HUNTER. It is in your packet.

Mr. LENT [continuing]. To talk about the chart while the gentleman was referring to it.

OK, go ahead.

Mr. HUNTER. At the top there were those kinds of cuts in the tort liability regime and in the liability insurance rates.

In 1975–76 we were hearing that the sky was falling; that tort reform was required; we needed to do all kinds of things to the tort system.

Up here—a few years later on the chart—they were cutting prices 95 percent for the same liability insurance. In fact, up here at the top in 1981 they were writing insurance on liability after the event. The MGM Grand Hotel is a classic example of that.

Months after the fire at the MGM Grand in November 1980, they put together a package called Retroactive Liability Insurance to write the losses on the MGM Grand Hotel. They have subsequently paid $75 million off on that, which is 13 times what they have paid in all the day care centers last year, on that one retroactive liability policy when they knew they had a loss. And this was liability insurance, dreaded liability insurance.

It was no longer dreaded. It depends where you are on the cycle.

Now we are down here again, and what do we see; things like this—now let's restore civil justice, a major ad campaign underway by insurers. Probably they are spending—you ought to ask them—probably they are spending nearly as much on this campaign as they spent on all day care center losses last year. What is going on?

During the mid-1970's, 100- and 200-percent rate increases were granted, which led to those huge profit jumps. And, as the profits rose, as I say, all the talk of tort reform vanished.

Now the industry is back at the bottom. A 3-percent rate of return on net worth is too low, I grant you that. The industry needs a minor rate adjustment; 5 percent plus inflation, roughly.

But what they have done is far in excess of that. You must find out why day care centers, nurseries and all the rest—I could go on with a long list, why are they losing their insurance; architects, lawyers, doctors having price increases up to 1,000 percent.

Why did 15 of 28 day care insurers leave the Maryland market, leaving only two insurers writing new business generally, and both of those eliminating child abuse from their coverage.

A total abandonment of child abuse, from 28 to zero in a year, and no claims. What is going on?

I think it is a plan by insurers to take advantage of the low-profit part of the cycle to extort higher prices and take away the legal rights of victims.

The Maryland day care withdrawal was called hysteria by that State's insurance commissioner, at Congressman Miller's subcommittee.

I think their plan is working. Here is their stockmarket performance over the same period of time as the cycle, the same years.

Their stockmarket performance is spectacular compared to any kind of industry average; 3 or 400 percent faster than the Dow Jones has increased over that period of time, and more than double, as Mr. Nader testified, this year.

Why is the stockmarket responding so, and why is every major stockbroker putting property casualty insurance stocks on their buy list?

It is because the insurance companies are getting price increases more than they need Brokers we have talked to said they expect the rate of return net worth to approach 30 percent by the end of next year.

The States just don't have the expertise to stem the tides. Half the States have no actuaries. Aetna Casualty & Surety Co. has more than twice the number of actuaries than are in the entire State regulatory system. Only five States employ fellows of the Casualty Actuarial Society. Those are the experts that are most qualified to handle liability insurance ratemaking.

They don't have the expertise even if you assume they have the will, which is a fairly huge leap of faith—if you review the GAO study of 1979. They conclude there was no arm's length relationship between the insurers and the regulators—even if you assume they have the will, they don't have the horses. And that is why Wall Street has reacted, because they know that the insurance prices are going to go up in excess of what is needed.

Now, what can be done?

The small businesses are being hit very hard. We think there is an illegal boycott.

Attached to my statement is a letter to the Justice Department asking them to look into that, whether there is an illegal boycott or not.

You heard Mr. Nader quote John Byrne and some of the others. We think there is an illegal boycott. We also think there is illegal product fixing not protected by the antitrust exemption, as opposed to price fixing. They are trying jointly to change the form This is what Lloyds of London says it wants. It wants a claims-made form; they want defense costs inside the limits, they want everything to come out of the victim's hide.

Now I am not opposed generically to tort reform. I got President Ford and President Carter both to support National No-Fault Auto Insurance while I was Federal Insurance Administrator.

We had a 27-volume DOT study first. And, we didn't have a gun pointed to our heads. We did it carefully, analytically, and that is what needs to be done.

I much agree with what was said by Congressman Miller. You have to look very carefully at these things and separate the fact from the huge fiction that is going on here.

Second, we ask Congress to review the antitrust exemption and delegation of regulatory authority to the States. The McCarran-Ferguson Act may have outlived its usefulness, and we ask you to look at it.

Third, we call on Congress to enact legislation to enable the Federal Government to offer reinsurance to insurers who agree to underwrite by national or State pools, day care centers, nurse-midwives and other risks that meet safety criteria. I am not asking you to insure people who are not safe.

I call your attention—I have given your staff a bill that we have drafted, and the plan is modeled after the successful program that kept insurance available in the inner cities during the riot time. I administered that program. We made $125 million profit for Treasury with it.

I think the Federal Government could make money offering reinsurance in this market.

Fourth, we ask Congress to look anew at the question of requiring licenses of alien insurers who insure or reinsure in a State without a State license.

I suggest it is inappropriate for Lloyds of London to try to call the shots as to what coverage is going to be offered in this country by claiming huge losses, but no one can verify their numbers because they are not regulated. Given their scandals of recent years, I would say that we need some careful look at Lloyds of London and the insurers that operate in this country with no license.

Now, Senator Dodd had put a bill in—the senior Senator Dodd—S. 1705, on June 13, 1963, to do just that. I request that you take a look at that approach.

In conclusion, I would like to say that the insurance industry is really attempting a raid on America's pocketbook and the States are for the main part, with some exception, ineffective in trying to deal with it.

Insurance which should stabilize the economy is instead creating turmoil and creating it out of whole cloth. Worst of all, it is using this self-created crisis to mount an all out attack on tort law and victims' rights.

And, I would again reiterate what Congressman Miller said, that we have to separate these two issues and look at them separately.

Your hearing, Mr. Chairman, is an important step to try to separate these things and look at them carefully, and I encourage you to continue.

I am glad you are going to have some more hearings. I appreciate it.

[Testimony resumes on p. 80.]

[The prepared statement of Mr. Hunter follows:]

TESTIMONY OF

J.ROBERT HUNTER
PRESIDENT, NATIONAL INSURANCE CONSUMER ORGANIZATION

Good morning Mr. Chairman and Members of the Subcommittee. I am Bob Hunter, President of NICO.

OVERVIEW

We are here this morning to discuss a mounting crisis in America, a crisis which involves every man, woman and child: the nation is losing its liability insurance. (See Chart Number 1.) Day care centers are losing their insurance and are being forced to close, perhaps driving second breadwinners out of work or creating new latchkey children. Nurse-midwives are losing their insurance and the lower cost birthing centers are shutting down. Doctors are marching on state capitals because insurance is unavailable or costs have skyrocketed. Cities, transit authorities, even whole states are losing their liability insurance. One of the leading auto insurers in the District of Columbia has pulled out. The list goes on and on.

And prices have skyrocketed. As Chart Number two shows, the cost of insuring an auto in America has gone up at 9.1% for the first 6 months of 1985, exceeding the rate of change for all of 1984. 1/ The annualized rate of change is 18.2%, a record dollar change.

What is going on here? Are these practices of insurers justified?

The answer is "NO!" What we are witnessing is a manufactured crisis intended to bloat insurer profits and reduce victims rights.

Property-Casualty insurance has a cyclical profitability, as Chart Number 3 shows. 2/ In 1984, if you accept the insurer's whopping reserve increases as valid (quite a large leap of faith), they earned about a 3% rate of return on net worth (equity). That is too low. It would indicate that their premiums were about 5% short. If their premiums had been 5% higher, they would have earned a rate of return on net worth of about 15%, more than enough for an industry of the low to average riskiness of Property/Casualty insurance.3/

A five percent premium shortfall is not a crisis. Yet we see all of the cancellations and mammoth price increases such as:

- A 70% increase for OB/GYNs in Maryland (totally unjustified -- per analysis, attached as Exhibit I).
- 300% to 900% increases in lawyer and architect malpractice insurance premiums around the country.
- Increases of 200% to 500% for the day care centers who can get insurance. Many can't.

o 300% to 1000% increases for public transit authorities.

The list goes on and on, but the statistics don't justify any of this!

What is going on?

THE LAST CYCLE BOTTOM - 1974/5

If you look again at the cycle chart you will see that 1984 was a typical "bottom-of-the-cycle" year. The last time it happened was in the mid-1970's when I served as Federal Insurance Administrator. At that time, the country observed the twin crises of medical malpractice and product liability unavailability and skyrocketing premiums.

After insurers abandoned the medical and product manufacturer lines, the federal government reviewed the situation. I was fortunate to be part of the interagency working groups that found that there was no justification for the insurer actions. 4/ We concluded that the insurers had just panicked from lack of data.

But look at what happened; their profits skyrocketed to all time record levels. They learned that the state regulators would, during the panic, give away the store in rate increases. They also learned that state legislators would act to reduce victims' rights in the wake of the panic (over half the states did so 5/). The fact that they achieved much of their 1975 legislative agenda and now are back for a bigger bite from the apple is very significant. Where will this raid on victims' rights end?

They are applying the lessons they learned in the mid-1970's very well today -- to day care centers, to nurse-midwives, to doctors, to product manufacturers, and so on. They are petitioning Congress for product liability tort law changes and the states for changes in other tort systems.

THE HEAT IS ON

Some property/casualty officials have made statements in the public record that: "It is right for the industry to withdraw and let the pressures for reform build in the courts and in the state legislatures." (Journal of Commerce, 6/18/85) Reinsurance, a critical aspect of maintaining available and affordable insurance rates may not be available from overseas because syndicates would "simply not write reinsurance for the American casualty industry" in 1986. A representative of that overseas market (Lloyd's of London) was recently reported to have said that if a new policy form is not adopted by state regula---- reinsurance wouldn't be provided to American liability underwriters.

Wall Street knows what is going on. Chart Number 4 shows that the property/casualty stocks have soared to record highs more than doubling the Dow Jones Industrial Average rise in 1985. 6/ Wall Street expects state regulators to allow excessive rate increases; Wall Street is right! At the end of the first six months of 1985, the surplus of insurers has skyrocketed by $8 billion, over the year earlier figure, a growth of 13.4%. 7/

Insurers blame this crisis on the courts and the tort law and say the only way to fix it is to take away as many victims' rights as possible. They can point to such statistics as these:

> Of 28 insurers writing liability insurance for day care centers in Maryland last year, 15 have left the market. Of the remaining 13, six will not write any new business. The last 7, those who will write new business, all have excluded child abuse from their policies. The Maryland Commissioner of Insurance has termed the pull out "hysteria" since no data supports it. 8/

Insurers will say this points to the need for tort reform, 9/ while admitting that data don't justify the pull out. 10/ I believe it shows joint action intend to create an atmosphere where rates can be put too high and legislators will be intimidated into action designed to take away victims' rights. Further, at the top of the cycle a few years ago, the now-dreaded liability insurance prices were being slashed wildly and even being sold after the insured event happened, such as in the case of the MGM Grand Hotel fire where liability coverage was written months after the fire. 11/ If tort reform was so desperately needed in 1974 and 1975, why not in 1981? Why again today? The crisis is within the insurance industry, not in the courts.

Now, insurance premiums represent 11.1% of the disposable income in this country. 12/ It is the fourth leading purchase Americans make (behind food, housing and federal income taxes, although we expect it to pass federal taxes this year). It is growing at an 18% rate for the first six months (see charts Number 5 and 6). 13/

THE MCCARRAN-FERGUSON ACT

In 1944, the Supreme Court found that insurance was interstate commerce and, thus, subject to anti-trust and other federal statutes. In 1945, under heavy insurer pressure, you passed the McCarran-Ferguson Act which uniquely exempts insurance from the federal anti-trust laws (except should intimidation, coercion or boycott occur). Congress delegated the authority to regulate insurance to the states with no standards for regulatory excellence and no ongoing congressional oversight. Indeed, the FTC cannot even study

insurance under current law 14/ unless you specifically authorize it in advance. (FTC's power was revoked because they had the audacity to point out that whole life insurance was not a wise purchase for most Americans. The fact that the FTC was right did not alter their fate.)

The immensely important McCarran-Ferguson Act was adopted by that earlier Congress without benefit of a hearing. The legislative history makes it clear that President Roosevelt wanted only a short, two or three-year moritorium after which anti-trust laws would fully apply. 15/ That is, in fact, what both houses of Congress adopted but their language was somewhat different, requiring a conference. Mysteriously, the conference committee reported back a bill that continues in effect today; an infinite moritorium.

Every independent study of insurance concludes that the states have failed mysteriously in their attempts to regulate this giant industry. 16/

The states have allowed this crisis to happen. Had they been equipped to keep prices to statutory standards (all states require that the rates be "not excessive, not inadequate, not unfairly discriminatory") we would not be in the mess we are in today with clearly excessive prices going into effect routinely around the nation and unfair cancellations rampant.

WHAT SHOULD CONGRESS DO?

(1) We call upon the Judiciary Committees of both houses to review the McCarran-Ferguson Act to determine if it is working to protect America. The quality of state regulation is documented to be inadequate; the insolvency funds are a "Maryland S&L Crisis Waiting to Happen."

(2) NICO also believes that the approach enacted at a previous bottom, 1968/9 is worthy of consideration by you: The Urban Property Protection and Reinsurance Act of 1968 was a response to the unavailability of insurance in the inner cities in the wake of the riot situation of the late 60's.17/

To be sure, the predicate for the withdrawal of riot insurance was strong, given the very serious situation extant in the country at the time. But the finding of the President's Panel on the Insurance Crisis is just as valid for the day care provider community today and others losing coverage as it was for the inner city communities of the late 60's: "Communities without insurance are communities without hope." 18/ Using the day care situation as an example, providers will have to shut down, possibly forcing spouses to decide among themselves which one will have to stop working, or the latchkey situation will be exacerbated, or other undesirable results will be forced on parents. Some families

may even have to give up a home for loss of the second income, situations not unlike the loss of mortgage following loss of insurance in inner city areas plagued by riot almost two decades ago.

In the riot insurance crisis, the federal government agreed to reinsure (insure the insurance companies -- a sort of lay-off bookie arrangement) the insurers against the specified peril of riot and civil commotion in return for a reinsurance premium and a commitment to participate in a pool to make sure insurance is available to all residents whose homes met reasonable standards of insurability.

The federal government made $125 million writing this reinsurance!

The cities were saved from the sure death that being uninsured brings in twentieth century America!

The program worked well.

I think that a program of stand-by authority should be prepared to take care of the day care and nurse-midwives current problem (and, perhaps, some of the others). The authority should be granted to cover future crises as well, to stabilize the insurance profit cycle's harsh symptoms. A copy of a draft bill to accomplish this has been provided to your staff.

When a line of insurance became severely distressed, representatives of those purchasers could appeal to the agency given authority to reinsure. The agency would make a finding as to the extent and cause of the dislocation. If a distressed situation is certified, then the agency could offer reinsurance to insurers who would agree to make a market in the line. Following meetings with the insurers, the agency head would determine what the cause of distress was and would offer to reinsure only that cause (e.g., only reinsure the peril of child abuse for day care liability if that is the finding). Insurers would pay a reinsurance premium designed to be self-sufficient.

Insurers, the administrator of the prugram and representatives of the distressed industry would meet to set standards for insurability under which those who qualify are assured of an insurance market.

Studies will be undertaken to determine if other longer range action (risk management, tort reform, etc.) is also needed to resolve underlying problems.

Funding for this program would come from reinsurance premiums. I also envision a small surcharge, perhaps one-quarter of one percent of premiums written by all property/casualty insurers, to back up the program. This is in case

premiums are insufficient over a short period or if it is determined by Congress that some short term subsidy is required to stabilize a distressed line sometime in the future.

The one-quarter of one percent surcharge would cost only 81 cents on the average private passenger car premium but would yield over $300 million this year. Over a ten year cycle, with a 10% growth in premiums and a 10% interest rate, $7 billion would flow into the Treasury. I would envision these funds being used in the general revenue area, but carefully accounted for to be available to the agency head when needed.

(3) NICO has asked the Department of Justice to review the evidence to see if a conspiracy to boycott insureds has occurred in Day Care insurance and other lines, the intent of which is to intimidate state regulation into granting excessive rate increases and to intimidate state and federal legislators into passing unjustified tort law modifications which will maximize insurer profit levels. 19/ Such boycotts and intimidations are not exempt from federal review under the provisions of the McCarran-Ferguson Act. We call upon you to monitor Justice's activity as respects this important request.

(4) We call upon Congress to require federal licensing of alien insurers that are not licensed by any state in this nation but who insure or reinsure here. If Lloyd's of London will use its economic clout to dictate our nation's policy forms, we think they should be subject to review by some authority here. A copy of a draft bill that would accomplish this has been given to your staff.

CONCLUSION

America deserves a better deal on its insurance. The federal government cannot sit idly by and let the insurance industry hold day care providers, nurse-midwives, and others, hostage in a large game beyond the providers' control. The terrori tactics of insurers every 10 years at cycle bottom must be dealt with in a systematic way that adds the stability to our economy that insurance is meant to deliver. This price gouging must be stopped. It is time the Congress began to look seriously at the delegation it made to the states in 1945 to see if we are, as a nation, getting the most we can out of that eleven percent of our disposable income we pay into insurance premiums.

FOOTNOTES

1/ CPI data on "auto insurance", Bureau of Labor Statistics.

2/ Source of data: Citybank Economics and Insurance Services Office.

3/ For a discussion of risk in the property/casualty insurance business, see Investment Income and Profitability in Property/Casualty Insurance Ratemaking, J.R. Hunter and J.W. Wilson, 1983, Chapter 5.

4/ Hearing on December 3, 1975, Subcommittee on Health of the Committee on Labor and Public Welfare, US Senate. Among the interesting data supplied by ISO at that hearing were exhibits that showed that the average claim cost ISO used for ratemaking significantly exceeded the limit of liability, clearly ratemaking that had run amok. That led to this exchange:

Sen. Laxalt: Is malpractice always a loser as far as carriers are concerned?

Mr. Hunter: If they charge these rates, they could not help but win. (Page 141.)

In John Guinther's book, The Malpractitioners, Anchor Press, 1978, Guinther cites this exchange at page 169 in a chapter entitled "They Could Not Help But Win." In the following chapter, called "They Won," Guinther reviewed the later experience.

Final Report, Product Liability Task Force. Report on Product Liability Ratemaking, Product Liability and Accident Compensation Task Force, US Department of Commerce, 1980. At page ix the Report states that "overly subjective ratemaking practices were one of the principal causes of the product liability insurance problem."

5/ St Louis Post Dispatch, Section B, P.3, 4/14/84.

6/ Source of data: Best's Property/Casualty Stock Index, A.M. Best and Company, Oldwick, NJ.

7/ According to the Insurance Information Institute's Executive Letter of August 26, 1985, Policyholder surplus grew from $58.2 billion as of 6/30/84 to $66.0 billion as of 6/30/85.

8/ "The day care facilities have been caught up in t' , availability crunch and are being deemed higher risk, not necessarily based on a claims experience but due more to an insurance hysteria . . ." Testimony of Edward J. Muhl, Insurance Commissioner of the State of Maryland, before the

House Select Committee on Children, Youth and Families, July 30, 1985.

9/ "Any permanent solution (of the day care insurance crisis) will require significant changes in the tort system." Testimony of Frank Neuhauser, Vice-President and Actuary for AIG (a leading insurer of day care centers) before the House Select Committee on Children, Youth and Families, July 30, 1985.

10/ "The countrywide experience for those companies reporting premium and loss data to the Insurance Services Office . . . appears to conform with the current loss experience for the majority of commercial insurance lines . . (these data) do not suggest that insurers should abandon the market." Testimony of James L. Kimble, Senior Counsel, American Insurance Association, before the House Select Committee on Children, Youth and Families, July 30, 1985. The testimony was also endorsed by the Alliance of American Insurers.

11/ See, for instance, the National Underwriter, 11/20/81, page 1, where it says:

> A large commercial umbrella (liability) risk came up for renewal and was rated at $105,000, about the same as the previous year. But the insured was not satisfied. Aware of the aggresive rate competition in the commercial lines market today, he decided to shop around. He approached a second agent, who submitted the very same risk to a different company, which offered to write it for just $20,000.
>
> But the insured was still not happy. He continued shopping and eventually the original company, which originally wanted $105,000 came back and took the business for $5,000. That's right, $5,000. (Emphasis added.)

12/

Item	1984 Amount Spent in Billions a/	Column (1) - 1984 Disposable Income of $2,578.1 Billion a/
Food	444.3	17.2%
Housing	397.8	15.4
Personal Income Taxes	302.6	11.7
INSURANCE b/	287.1	11.1

a/ Source: US Department of Commerce, Bureau of Economic Analysis.
b/ Source: Bests Management Reports, December 31, 1984, page 1.
Life Insurance Fact Book, page 56.
Blue Cross Association, Telephone call of 1/25/85.

13/ Source: Best's Aggregates and Averages and Best's Advance Rating Report of July 15, 1985.

14/ The law was euphemistically entitled the "FTC Improvements Act of 1979."

15/ See Statement of Honorable Claude Pepper before the Subcommittee on Monopolies and Commercial Law on the Insurance Industry's Antitrust Exemption, April 11, 1984; found at page 5 of the Subcommittee's report, Competition in the Insurance Industry.

16/ See, for instance, Issues and Needed Improvements in State Regulation of the Insurance Business, General Accounting Office, 1979; Invisible Bankers, Andrew Tobias, Linden Press, 1982; The Life Insurance Game, Ronald Kessler, Holt, Rinehart and Winston, 1985; "Protection for Sale: The Insurance Industry," NBC-TV Nes, 1981; Risk, Reality and Reason, the Conference of Insurance Legislators, September, 1983.

One of the tests of state preparedness to deal with a crisis in availability and pricing of liability insurance is actuarial staff. Of the 52 states (including DC and Puerto Rico) NICO surveyed, we find that 26 have actuaries. So one-half of the states have no actuaries at all.
There are 62 actuaries employed by the states, of the 7,682 actuaries in the nation. It is well known in the industry that those best suited to deal with matters pertaining to liability insurance are those who have passed the examinations enabeling them to be "Fellows" in the Casualty Actuarial Sociaty. State regulation has only 8 such persons. They are employed by only 5 states [Connecticut (1), Massachusetts (1), Michigan (1), New Jersey (1) and New York (4).]
Aetna Life and Casualty Insurance Company alone employs 126 actuaries. Travelers has 100.

Source of data: American Academy of Actuaries 1985 Yearbook and Directory of Members by Business Affiliation.

17/ Public Law 90-448, 82 Stat. 476; 12 U.S.C. 1749bbb, 42 U.S.C. 4011.

18/ Meeting the Insurance Crisis of Our Cities, A report of the President's National Advisory Panel on Insurance in Riot-Affected Areas, January, 1968, p. 1.

19/ See Exhibit II for a copy of the letter to the Justice Department.

NATIONAL INSURANCE
CONSUMER ORGANIZATION

CHART #1

Midwives Facing Loss of Insur...

NY TIMES 7/13/85

By CAROL LAWSON

5 Rocky Mt. States ...e Liability Cover 6/27/85

We've been ... the three thousand companies ... country, only ... them are willing ... vernment entitie...

Birthing Centers Face Shortage of Cover

By C.A. CARPENTER

7/2/85

Insurance Premiu... 7/5/85

GLOUCESTER, Mass. — Sam LaGrasso was sitting outside the St. Peter's Club on Rogers Street here, basking in the sun. He would rather have been fishing.

But Mr. LaGrasso, 44, is one of more than 20 Gloucester commercial fishermen who in the last two weeks have been forced to let their trawlers sit idle because their insurance has been canceled.

Transit Systems Fa... Liability Shortage 7/12/85

The loss ratio for publ... transportation systems has remained constant, yet members are experiencing premium increases from 300 percent to 1,000 percent.

Fireworks Makers Face Loss of Insurance 7/2/85

By JAMES NOLAN

NEW YORK — A Fourth of July without an evening of "aah — boom — aah" is unthinkable. But the way things are in the specialty insurance industry, the ...

Auto Insurer To Discontinu... Service in D.C.

7/10/85 By Sandra Evans

Dairyland Insurance Co., the No. ... writer of auto insurance in the District, informed the city government yesterday that it is discontinuing insurance for all of its District policyholders by the end of this year because of high losses it has had ...

About 16,000 customers, most of them high-risk drivers with month-to-month policies, will have to scramble to get insurance from oth...

Day Care Insurance Imperiled

Policies Canceled, House Hearing Is Told

By Sandra Sugar

Rate hikes, capacity crunch seen with July 1 renewals 7/15/85

THE 1985 INSURANCE CRISIS

WHAT'S GOING ON HERE?

Risky Business

Liability Insurance Is Difficult to Find Now For Directors, Officers 7/10/85

Suits by Shareholders Cause Premiums to Skyrocket, Insurers Cancel Policies

The worst is yet to come, reinsurers, brokers predict

By DOUGLAS McLEOD 7/15/85

It's summertime, but the living is far from easy for reinsurance buyers.

After being clobbered during last January's renewals with rate hikes, capacity shortages and more-restrictive policy terms, ceding companies were hit even harder during July 1 renewals.

And there is no relief in sight as next January's renewal season approaches, brokers and reinsurers predict.

"I think it's going to be a bloodbath," said an underwriter at Constitution Reinsurance Corp. in New York, referring to next January's renewals, which brokers will start negotiating in the fall.

"Last year will look like a ... compared to this year," the underwriter says.

CHART #2

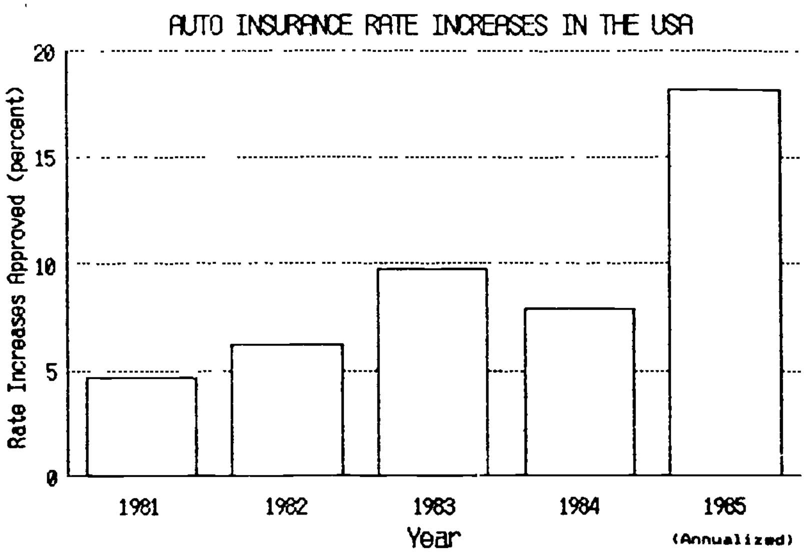
AUTO INSURANCE RATE INCREASES IN THE USA
Rate Increases Approved (percent)
20
15
10
5
0
1981
1982
1983
1984
1985
Year
(Annualized)

CHART #3

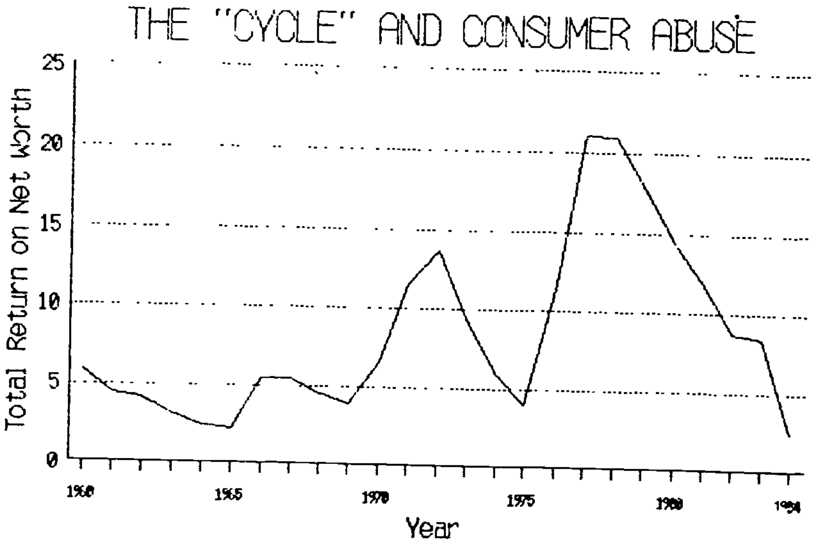
THE "CYCLE" AND CONSUMER ABUSE
Total Return on Net Worth
25
20
15
10
5
0
1960
1965
1970
1975
1980
1984
Year

CHART #4

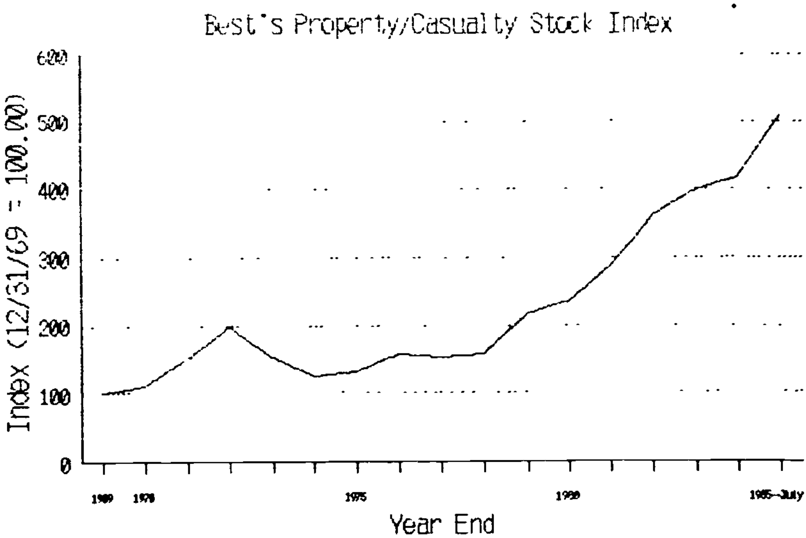
Best's Property/Casualty Stock Index
Index (12/31/69 = 100.00)
600
500
400
300
200
100
0
1969
1970
1975
1980
1985--July
Year End

CHART #5

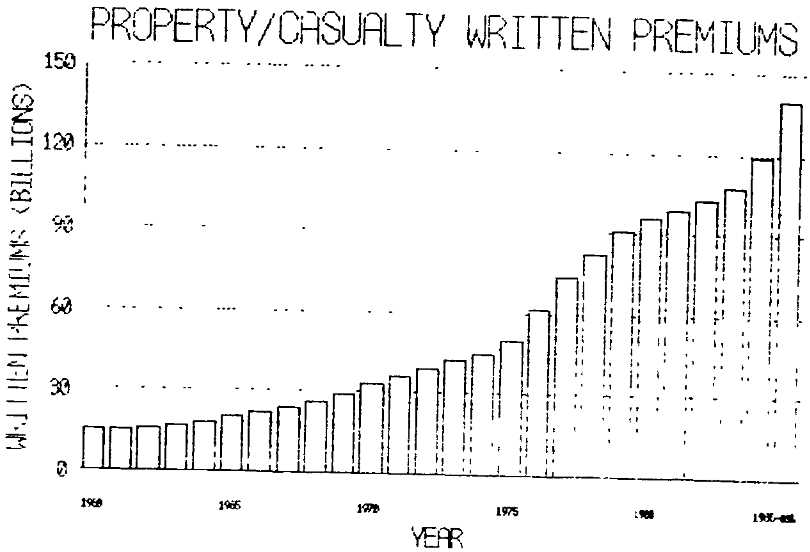
PROPERTY/CASUALTY WRITTEN PREMIUMS
WRITTEN PREMIUMS (BILLIONS)
150
120
90
60
30
0
1960
1965
1970
1975
1980
YEAR

CHART #6

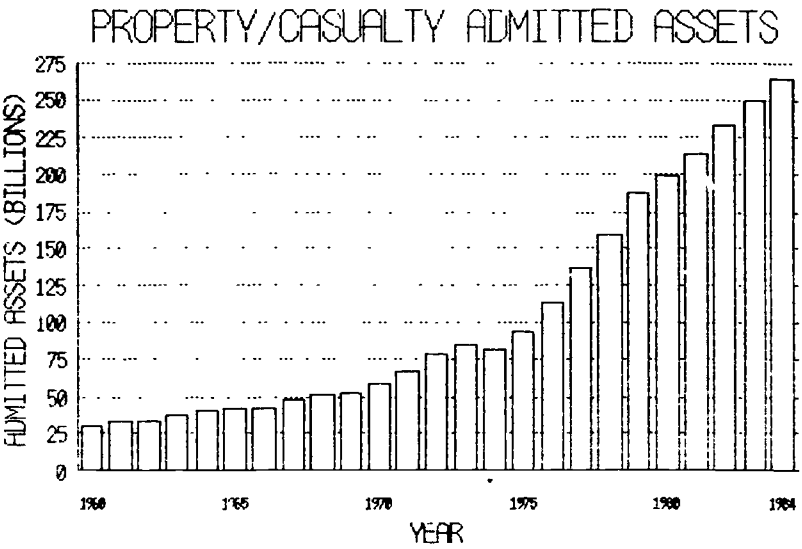
PROPERTY/CASUALTY ADMITTED ASSETS
ADMITTED ASSETS (BILLIONS)
275
250
225
200
175
150
125
100
75
50
25
0
1960
1965
1970
1975
1980
1984
YEAR

EXHIBIT I

Analysis of Rate Filing of

MEDICAL MUTUAL LIABILITY INSURANCE SOCIETY OF MARYLAND

Filing Date: May 16, 1985   Effective: July 1, 1985

J. ROBERT HUNTER

Fellow, Casualty Actuarial Society
Member, American Academy of Actuaries
President, National Insurance Consumer Organization
Former Federal Insurance Administrator

BACKGROUND

On May 16, 1985, the Medical Mutual Liability Insurance Society of Maryland (MMLIS) filed for an increase in malpractice premiums of +29%. The filing also requested changes in the relativities between classes, the most notable of which was a one-third increase in Class 8 (OB/GYN Surgery). The total impact of the overall rate change of +29% and the class relativity change of +33.3% on OB/GYN surgeons was to increase their rates by 66.7%. For the highest rated territory, these doctors had their rates raised from $25,429 to $42,393. This did not please the OB/ GYN community.

WAS THE OVERALL 29% RATE INCREASE JUSTIFIED?

In my opinion, there was no justification for an overall rate increase of 29%. Indeed, I believe that the filing supports a reduction in premiums rather than an increase. Here's why:

- The filing incorrectly assumes that the yield on investments that the MMLIS will earn is 5%, an unrealistically low assumption, and

- The filing incorrectly assumes that inflation in the future will be at double-digit levels.

When proper assumptions are made on just these two items, even accepting other major assumptions (such as their reserves are accurate), a rate reduction of 10.5% is indicated.

HOW SHOULD INVESTMENT INCOME BE FACTORED IN?

To do the job properly, a full blown total return analysis should be undertaken. The National Association of Insurance Commissioners adopted the total return approach at their June, 1984 meeting, and issued a report detailing several approaches. Under a total return approach, all income is analyzed to determine what overall profit the company will make under a given set of rates and a comparison of that potential earning power to the needed margin to attract risk capital is undertaken. It is a sophisticated, highly desirable approach that should be used in Maryland, as the NAIC recommended for all regulated lines.

In that the filing was woefully short of the data needed to undertake total return analysis, I decided to accept, for review purposes, the MMLIS approach to discounting the cash flows (their Exhibit 5, my Exhibit "A", attached). On my exhibit, you will see the MMLIS approach as typed and mine in

handwriting. MMLIS discounted the losses based on a distribution of losses paid by time. Presumably this is based on their Maryland experience, the filing does not identify that.

The average claim takes a bit over 7 years to pay. This means that MMLIS holds the money in reserve for that long before they pay the average claim. Obviously this means that the reserves, which are fully funded today under statuatory accounting rules, will produce a significant amount of investment income.

The MMLIS approach assumes that they will earn 5% on their invested reserves. This is obviously too low. MMLIS has earned, according to their 1984 Annual Statement, the following yields on their total assets (including assets not invested or used for business--such as properties) the following:

1982	9.1%
1983	8.9%
1984	9.3%

Other filers recognize that the yield is not so absurdly low. For example, on May 17, 1985 the leading writer of medical malpractice insurance in the country, St. Paul submitted a filing in South Carolina in which it used a 10.5% yield to discount that state's cash flow. (see my Exhibit "B")

I have chosen to use a 10% discount rate, which is reasonable for fully invested assets of MMLIS. That change is shown on Exhibit "A". It results in a discount for investment income of 43% rather than 26% based on the unjustified 5% yield assumption. If that change is carried through to the rate level itself, the rate filing would have been for a <u>reduction</u> in rates of 1.4% rather than an increase of 29%. The calculation of the reduction is found on Exhibit "C", attached.

TREND

MMLIS displayed its own Maryland data for trend on its Exhibit 4, my Exhibit "D". It carefully analyzed the data and concluded that the range of results were between an annual trend of +7.8% based on straight line projection, and +9.3% based on exponential line projection. The data are company specific and Maryland specific andthrough the most recent year, 1983.

For some reason, the filer then displays data for other insurers, for other states, that is old data. (See Exhibit

"E"). This experience is from a period of high inflation and is not relevant, in my opinion to the case at hand. For one thing, the federal government has reported that medical inflation rates in the nation are below 10%, certainly nr where near the 16% figure that the irrelevant data prod ». These data should not be given weight, in my estimation.

I selected a trend of 9% for the purposes of this review. It gives weight to the fact that the exponential line has a slightly better "fit" to the data and is within the range as calculated by MMLIS, but near the exponential side. I also chose to apply the trend exponentially (this gives a higher answer than using a straight line).

Looking again at Exhibit "C", the use of the amended trend, coupled with the 10% yield assumption produces an indicated rate level reduction of 10.5%

SENSITIVITY ANALYSIS

If we used a yield of only 9% (less than MMLIS earns, even on all assets including cash) and use a trend of 10% (ehich is more than that realized by MMLIS and more than that in the nation today) the indicated rate would be a reduction of 0.9%.

ANALYSIS OF CLASSIFICATION CHANGES

Incredibly, there is absoultely no justification for the changes in the classification differentials employed by MMLIS contained in the filing. The entire "justification" for the change is found on Exhibit "F", attached.

There are other, more minor changes made without a shread of evidence, such as the territorial relativity changes, and the increased limits changes.

BALANCE SHEET

MMLIS is as solid an insurer as there can be. Their 1984 balance sheet shows that the company enjoys a premium/surplus ratio of 1.2 to 1. This company appears to be over-capitalized. If the ratemaking has followed the current filing approach, it is no wonder.

CONCLUSION

This filing is not justified. An overall rate level decrease of 10.5% is needed, not a 29% increase. The class changes which so sharply impact the OB/GYN surgeon group is not justified in the filing, although their may be experience somewhere that supports that change. The filing should have been disapproved. It is particularly abusive to observe a 66.7% increase for OB/GYN surgeons with no justification. On the basis of the filing, the OB/GYN rate should have been decreased by 10.5%. This means that the OB/GYN surgeons in Maryland may be paying about 85% too much.

Exhibit "A"

MEDICAL MUTUAL LIABILITY INSURANCE SOCIETY OF MARYLAND

1985 PROFESSIONAL LIABILITY RATE LEVEL REVIEW - OCCURRENCE COVERAGE

PRESENT VALUE OF PAID MEDICAL MALPRACTICE CLAIMS

(OCCURRENCE BASIS)

Time Interval	Cum. Paid	% Paid Losses By Interval	Years of Discount (n)	Vn (5%)	10%	Present Value	
Up to 12 mos.	0.0%	0.0	0.5	.976	.954	-	
24	2.0	2.0	1.5	.929	.867	1.858	1.734
36	7.0	5.0	2.5	.885	.788	4.425	3.940
48	19.0	12.0	3.5	.843	.716	10.116	8.596
60	35.0	16.0	4.5	.803	.651	12.848	10.42[illegible]
72	53.0	18.0	5.5	.765	.592	13.770	10.65[illegible]
84	68.0	15.0	6.5	.728	.538	10.920	8.07[illegible]
96	79.0	11.0	7.5	.694	.489	7.634	5.38[illegible]
108	87.0	8.0	8.5	.661	.445	5.288	3.558
120	92.0	5.0	9.5	.629	.404	3.145	2.021
132	95.0	3.0	10.5	.599	.368	1.797	1.10[illegible]
144	97.0	2.0	11.5	.571	.334	1.142	.668
156	99.0	2.0	12.5	.543	.304	1.086	.60[illegible]
168	100.0	1.0	13.5	.518	.276	.518	.276
			Ave 7.1 yrs			74.547%	57.0[illegible]

St. Paul Fire and Marine Insurance Company
St. Paul Mercury Insurance Company
Physicians and Surgeons Professional Liability

Exhibit "B"

Exhibit C
Loss and Loss Expense
Payout Patterns

Year	Cumulative Annual Payout	Incremental Annual Payout	Present Value*
1	.061	.061	.059
2	.275	.214	.187
3	.496	.221	.175
4	.668	.172	.124
5	.786	.118	.076
6	.869	.083	.049
7	.910	.041	.022
8	.952	.042	.020
9	.976	.024	.011
10	1.000	.024	.009
		1.000	.732

* Discounted claims payments at .0.5% pre-tax.

Exhibit "C"

MEDICAL MUTUAL LIABILITY INSURANCE SOCIETY OF MARYLAND

1985 Professional Liability Rate Level Review - Occurrence Coverage

Total Limits Rate Level Indication -- $000's

(1) Calendar/ Accident Year	(2) E. P. at Current Rate Level (Exh. 3)	(3) Ultimate Incurred Loss & ALAE (Exh. 2)		(4) Trend Factor to 7/1/86 at 11% 9%	(5) Losses Trended to 7/1/86 (3)x(4)		(6) Loss Ratio at Current Rate Level (5)/(2)	
1979	33,395	24,688	1.826	2.076	51,255	45,130	1.535	1.354
1980	35,732	25,235	1.677	1.870	47,200	42,319	1.321	1.184
1981	33,872	25,904	1.539	1.685	43,649	39,866	1.289	1.177
1982	28,984	25,414	1.412	1.518	38,580	35,885	1.331	1.238
1983	18,203	18,854	1.245	1.368	25,785	24,416	1.417	1.341
	150,185				206,470		1.375	
					187,816		1.249	

Annual Trend Factor: 11.0%
(Exhibit 4)

a)	Five year loss ratio at current rate level:	1.249	1.375	
b)	Discount for investment income at 5.0%: (10%) (Exhibit 5)	.570	0.745	.570
c)	Discounted loss and ALAE ratio (a) x (b):	.712	1.024	.784
d)	Provision for Unallocated LAE (Exhibit 6)	1.05	1.050	
e)	Discounted loss and LAE ratio (c) x (d):	.748	1.075	.823
f)	Permissible discounted loss and LAE ratio: (Exhibit 6)	.835	0.835	
g)	Indicated rate level increase (e) / (f):	-10.5	1.288	-1.4%
h)	Selected rate level increase		1.290	

INVESTMENT INCOME AND TREND CHANGE

ONLY INVESTMENT INCOME CHANGE.

Exhibit "D"

MEDICAL MUTUAL LIABILITY INSURANCE SOCIETY OF MARYLAND

1985 RATE LEVEL REVIEW - PROFESSIONAL LIABILITY - OCCURRENCE COVERAGE

TREND IN TOTAL LIMITS LOSS RATIOS AT CURRENT RATES

($000'S)

(1) Calendar/ Accident Year	(2) Earned Premium at Current Rate Level	(3) Ultimate Incurred Loss and ALAE	(4) Loss Ratio at Current Rates	(5) Linear Fit	(6) Exponential Fit
1979	33,395	24,688	.739	.672	.683
1980	35,732	25,235	.706	.748	.747
1981	33,872	25,90[illegible]	.765	.825	.816
1982	28,984	25,41[illegible]	.877	.901	.893
1983	18,203	18,854	1.036	.978	.976
			Average Annual Trend:	+ 7.8%	+ 9.3%
			r :	.899	.906

(2) Exhibit 3

(3) Exhibit 2

(4) (3) / (2)

ISO COUNTRYWIDE TREND (Exh. 4A): 16% Irrelevant

Selected Trend Factor: 11%

I'd use 9.0%

EXHIBIT –
INSURANCE SERVICES OFFICE EXHIBIT 4A

COUNTRYWIDE#

Professional Liability Insurance
Calculation of Annual Trend Factor
Based on Basic Limits Loss Ratios at Present Rates

PHYSICIANS, SURGEONS AND DENTISTS

Basic Limits

(1) Policy Year Ending	(2) $100,000 Basic Limits Incurred Losses*	(3) Premium At Present Rates	Average Loss Ratio at Present Rates (4) (2)÷(3) Actual	(5) Exponential Curve of Best Fit
12/31/75	$167,810,058	$615,020,250	.273	.232
12/31/76	139,176,608	524,225,850	.265	.271
12/31/77+	181,630,098	638,830,853	.284	.316
12/31/78+	251,848,210	700,894,098	.359	.369
12/31/79+	280,590,219	717,382,127	.391	.430
12/31/80+	332,612,672	705,726,416	.474	.502
12/31/81+	426,038,352	684,461,050	.622	.585
12/31/82+	497,532,513	666,499,516	.746	.683

Average Annual Loss Ratio at Present Rates Trend...............16.6%

Excluding Texas and Massachusetts

* Losses include allocated loss adjustment expense and are developed to an ultimate settlement basis.

\+ Includes Claims Made Data.

Selected Annual Trend 16.0%

TS-PR-84-11
12/20/84

EXHIBIT 5

Exhibit "F"

MEDICAL MUTUAL LIABILITY INSURANCE SOCIETY OF MARYLAND

1985 PROFESSIONAL LIABILITY RATE LEVEL REVIEW

Effect of Proposed Classification Changes

Specialty	Description	Distribution Of Total Limits Premium	Present Relativity	Proposed Relativity
80240	Forensic Medicine	0.0 %	.75	.65
80232	Hypnosis	0.0	.75	.65
80248	Nutrition	0.0	.75	.65
80263	Ophthalmology-No Surgery	0.2	.75	.65
80235	Physiatry and Physical Medicine	0.2	.75	.65
80249	Psychiatry	0.3	1.00	.65
80250	Psychoanalysis	0.0	1.00	.65
80251	Psychosomatic Medicine	0.0	1.00	.65
80266	Pathology-No Surgery	0.5	1.00	.65
80261	Neurology-No Surgery	0.8	1.00	1.20
80253	Radiology-Diagnostic-No Surgery	0.5	1.20	1.80
80280	Radiology-Diagnostic-Minor Surgery	0.1	2.10	2.80
80145	Surgery-Urology	3.0	3.00	3.60
80155	Surgery-Plastic-Otorhinolaryngology	1.5	6.00	5.00
80156	Surgery-Plastic-N.O.C.	2.5	6.00	5.00
80141	Surgery-Cardiac	0.0	5.00	6.50
80150	Surgery-Cardiovascular	0.0	6.00	6.50
80153	Surgery-Obstetrics/Gynecology	8.0	9.00	12.00
80168	Surgery-Obstetrics	0.1	9.00	12.00
	All Other	82.3		
		100.0%		

Effect: +2.8%

Current Average Relativity: 2.15

Projected Average Relativity: 2.21

EXHIBIT II

LANDSMAN & LASTER

1503 21st STREET, N W
WASHINGTON, D C 20036

(202) 331-0800

JOHN L. LASTER
RON M LANDSMAN

August 14, 1985

Hon. Rick Rule
Acting Assistant Attorney General
Antitrust Division
United States Department of Justice
Tenth and Constitution Avenues, N.W.
Washington, D.C. 20530

Dear Mr. Rule:

I am writing on behalf of the National Insurance Consumer Organization to bring to your attention evidence of concerted anticompetitive conduct within the property/casualty insurance industry that is not exempt under the McCarran-Ferguson Act.

The industry is now going through one of its periodic capacity scares. As in previous incidents, the public suffers severe and economically debilitating dislocations. After a period of glut, when premiums drop to a fraction of their prior fixed-price levels, underwriting tightens like a vise and important major manufacturing and service industries find themselves unable to purchase insurance protection at any price from any company.

To be sure, much of this pattern may reflect nothing more than the operation of the business cycle in an industry not under reasonable and effective regulatory oversight at the national level. The extremely aggressive price competition in commercial property/casualty lines in the late 1970s, and perhaps the subsequent price increases as well, appears to reflect such market forces. Some of the industry's responses may also reflect the mindless herd instinct which so distinctively marks the insurance industry. This is perhaps to be expected in an industry with a long history of price-fixing and other cooperative anticompetitive arrangements under state regulation that from the consumers' perspective ranges from lax to impotent, but so be it.

But the response of the industry to recent developments in their customer industries -- and the statements of industry leaders explaining their conduct -- suggest that something more is occurring.

Spokesmen for the reinsurance industry have told state regulators that they plan to withdraw en masse if they -- the regulators -- do not approve new insurance policy forms jointly developed by the reinsurers and the industry price-fixing agency (Insurance Services Office, Inc.). These new policy forms severely

Mr. Rick Rule
August 14, 1985
Page Two

narrow the protection provided to the insurers' commercial customers, changes about which they are, to say the least, extremely unhappy. See Attachment A. Along the same lines, a well-known insurance company executive has justified the mass departure of insurers from medical, toxic waste, and directors' and officers' liability lines by "the social good" in "let[ting] the pressures build in the courts and the state legislatures" to change laws respecting their customers' -- and the insurers' -- liability. See Attachment B.

There is, finally, irrational market conduct that goes beyond even this industry's herd instinct. They have withdrawn from lines for risks with experience ranging from good to excellent and which even the insurers admit could and should be written. See Attachment C.

Boycotts to force action by state and federal officials, be they judges, legislators, or regulators, are illegal. The McCarran-Ferguson Act specifically does not exempt boycotts from federal antitrust enforcement. In St. Paul Fire and Marine Insurance Co. v. Barry, 438 U.S. 531 (1978), the Supreme Court held that the term boycott was broadly applicable to joint action to deny coverage to customers. Nor is there protection to be had under any of the familiar non-statutory exemptions. The Noerr-Pennington doctrine does not exempt "an express or implied agreement ... that the participants will jointly give up their trade freedom, or help one another to take away the trade freedom of others through ... boycotts ... ." Eastern Railroad Presidents Conference v. Noerr Motor Freight, Inc., 365 U.S. 127, 136 (1961). And Parker v. Brown, 317 U.S. 341 (1943), does not exempt joint product-fixing absent state statutes authorizing such joint action. The debates on the McCarran-Ferguson Act reflect absolutely no consideration of agreements respecting products, and the state laws enacted in response to it by and large do not adopt such joint action as state policy. Southern Motor Carriers Rate Conference v. United States, --- U.S. ---, 53 U.S.L.W. 4422 (March 27, 1985).

Property/casualty insurance industry conduct, as explained by industry leaders themselves, may be but a prelude to a larger campaign to force major industries, from the chemical and drug manufacturers to physicians and others, to bend to the interests and will of insurers. If their means include non-exempt joint anticompetitive action, however, then you may hold the key to important public protection. I urge you to investigate to ascertain whether the federal antitrust laws are being violated.

Yours truly,

Ron M. Landsman

Ron M. Landsman
Counsel, National Insurance
Consumer Organization

RML/kd

Appendix A

JEC 6/18/85

Insurers Told: Exit Some Lines

By JAMES NOLAN
Journal of Commerce Staff

WOODBRIDGE, N.J. — The insurance industry should quit covering doctors, chemical manufacturers and corporate officers and directors. And the sooner the industry quits such lines of business, the sooner it will free itself from its bondage to a court system "that has run amok."

This was the message delivered to a meeting of actuaries here Monday by John J. Byrne, chairman and chief executive officer of Geico Corp., the Washington-based personal lines insurance company.

Mr. Byrne said that the single thread running through such lines of business for underwriters was that they have fallen under the sway of the courts.

"There will be no problem with insuring homeowners or autos in the coming years," he said. "But anyone who puts his private capital behind lines such as malpractice is putting himself in the hands of a zany judge or jury out in California. To my mind, it is absolutely stupid."

Mr. Byrne's comments came in the midst of a discussion at a meeting of the Casualty Actuaries of New York about what kinds of insurance products might be available in the future.

The touchstone for the discussion was a presentation by the Insurance Services Office Inc., an industry-rating and data-gathering service. The ISO estimates that in the next few

'Anyone who puts his private capital behind lines such as malpractice is putting himself in the hands of a zany judge or jury out in California.'

years the insurance industry will suffer a $92 billion shortfall in capacity. This means that corporate America will not be able to buy all the insurance it needs because insurers ability to cover them will fall short by that amount.

Mr. Byrne said the industry was responsible to some extent in precipitating this by continuing to cover lines of business that are subject to court interpretation. "It will be [illegible] for the [illegible] to [illegible] know that the problem is not one for the insurance industry but for society as a whole. It is time for the industry to withdraw and let the pressure for reform build in the [illegible]," Mr. Byrne said.

He said he saw little hope for reform in such things as the federal program for Superfund, a toxic waste cleanup measure. He said the vast amount of money thus far spent by Superfund was to "educate lawyers on how to refine their suits brought on the part of plaintiffs against industry."

"Anybody who leaves his private capital where the courts can grab it has not done the right thing for his owners," Mr. Byrne said.

On a related score, Thomas A. Greene, president of his reinsurance brokerage firm in New York, said that still more pressure would be brought to bear on the American property and casualty industry by underwriters at Lloyd's of London. Mr. Greene said that beginning in 1986, Lloyd's syndicates would "simply not write reinsurance for the American casualty industry, especially in the lines mentioned by Mr. Byrne." He said further that reinsurance underwriters would virtually dictate to the ISO about a proposed commercial general liability form. He said the domestic reinsurance industry will not write treaties unless the industry adopts the new CGL form.

As to the stability of the insurance companies suffering through this trying period, at least one of the actuaries said that current measures of company solvency used by the National Association of Insurance Commissioners were less than adequate.

Kevin M. Ryan of the National Council of Compensation Insurance urged the actuaries to model industry solvency judgments on a study done by the Aetna Life & Casualty Co. a few years ago.

Aetna studied the financial data of companies that had actually failed and the resultant ratios were absolutely realistic, Mr. Ryan said.

(1)

EPA Chief Deems It Necessary To Keep Toxic Liability Powers

By LEAH R. YOUNG
Journal of Commerce Staff

WASHINGTON — The Environmental Protection Agency must keep the authority allowing it a wide choice of whom to sue for cleaning up toxic waste sites, Administrator Lee M. Thomas said.

While acknowledging that the market for all kinds of environmental insurance is drying up, Mr. Thomas insisted in an interview that the EPA cannot give up the "strict, joint and several liability" powers that courts have given it.

The insurance industry has been arguing that it cannot insure and collect premiums from individual companies when a court can require one or a few companies to pay all the costs of cleaning up a site.

That is especially true, insurers add, when many of the policies being interpreted by state courts never were intended to pay for hazardous waste cleanup.

But Mr Thomas pointed out that he is responsible for getting such sites cleaned up while ensuring to the extent possible that the polluter, not the federal government, bears the costs.

The insurance industry would like to divide liability so that its clients are held responsible only for their share of damage, but the EPA finds that in most Superfund waste cleanup sites substances are mixed and records are poor.

When the EPA tried to apportion responsibility — an approach that is surfacing again among some congressmen at the behest of the insurance industry — it became "just as controversial among the private parties as utilization of joint and several" liability, Mr. Thomas said.

The EPA tried to base responsibility on the volume of waste, he said, but the companies fell into long debates over whose waste was more toxic.

However, as adamant as he is that strict, joint and several liability must be part of any Superfund program, Mr. Thomas opposes attempts by House Energy and Commerce Subcommittee Chairman James Florio, D-N.J., to write it into the pending Superfund bill.

"We don't think it should be specifically mandated," Mr. Thomas said. "Trying to get language in the statute has the potential of opening up the whole issue again to litigation."

But Rep. Florio argues that while he is "heartened" by the district court rulings to date, "this principle could be gutted by a specific district court or by the Justice Department."

He wants to make sure that industry cannot convince the administration to abandon this unwritten interpretation.

Rep. Florio lost a battle in his subcommittee on the issue as a group headed by Energy and Commerce Committee Chairman John Dingell, D-Mich.

In spite of the setback, Rep. Florio has vowed to continue his fight on the issue, and for other provisions the subcommittee rejected, in the full committee and on the House floor

His rejection in subcommittee is no reason for rejoicing by the insurance industry. Many who opposed Rep. Florio support the views of Mr. Thomas.

Rep. Jim Slattery, D-Kan., explained that injecting joint and several liability into the legislation could lead to a situation in which the provision was either stricken or filibustered in the Senate.

That would create legislative history that might convince state courts that such liability is not part of Superfund.

While Mr. Thomas is determined to keep joint and several liability in spite of evidence of growing insurance problems, Mr. Thomas does not have any recommendations to alleviate the burden on the insurance industry.

He pointed out that a lot of the problems are not related just to Superfund, but rather to the general economic situation in the property-casualty insurance industry.

He noted that the European reinsurance market is drying up for environmental policies. There has been poor experience with asbestos, and a general desire to "establish a less risky base of insurance."

Under such circumstances, he said, he has been unable to get from the insurance industry any [illegible] steps taken at the federal level will result in a return to the [illegible] market.

Instead, insurance industry spokesmen will only say that if some steps are not taken "there is a chance we won't get back in the market," Mr. Thomas said.

It is possible that there is a need for federal involvement in the environmental liability field, but the debate has not reached the point where he thinks he can draw any conclu-

In the meantime, EPA recognizes that many hazardous waste sites being licensed under the Resource Conservation and Recovery Act may not prove financial responsibility on Nov 8 as required.

Without insurance, some facilities may use their own net worth, Mr Thomas said, but others may just be forced out of business.

Fewer facilities will require companies that are generating wastes to modify their procedures to incinerate or otherwise minimize waste that until now was cheaper to send to land disposal facilities.

It is too soon to analyze the impact of this scenario, he said, in light of the congressional decision to encourage companies to move away from land disposal.

The only thing he is at all sure of now is that solving the problems of insuring hazardous waste facilities would not solve the entire insurance dilemma.

The House subcommittee did vote against one provision that disturbed the insurance industry. Congressmen rejected an amendment to permit citizens to sue private parties if they perceived a dangerous situation being ignored by the Environmental Protection Agency.

Only one Florio amendment was attached to the Superfund bill that goes to the full Commerce Committee.

That provision requests that the House Ways and Means Committee devise as part of the taxing scheme an import fee to reduce the share of general federal revenues envisioned in the bill from $250 million to $110 million.

The idea is to tax imported feedstock derivatives equally with domestic feedstock components in order not to give an advantage to foreign derivatives.

Mr Thomas said the administration still opposes new Superfund taxes.

In Day-Care Crisis Cited

Official Criticizes Insurance Firms

By Sandra Sugawara
Washington Post Staff Writer

Maryland Insurance Commissioner Edward J. Muhl said yesterday that "hysteria" had caused insurance companies to discontinue coverage of day-care centers and that Maryland officials had blocked an attempt by one California firm to cancel 242 day-care policies.

Muhl also said that state officials were studying a wide variety of options, including the creation of a mutual liability insurance fund in Maryland similar to the one created in 1974 by the General Assembly to help physicians hit by an insurance malpractice crisis.

Muhl testified yesterday before the House Select Committee on Children, Youth and Families, which is holding hearings on the nationwide insurance crisis in the day-care industry. Muhl, who appeared on behalf of the National Association of Insurance Commissioners, critized insurance companies for wholesale cancellation of day-care policies, saying the insurance industry was overreacting to news accounts of sexual abuse and court suits involving some day-care centers.

Muhl said a California insurance carrier canceled policies at 242 Maryland day-care centers before they were to expire. He said he recently ordered that firm to revoke the midterm cancellations, although he said the company does not have to renew the policies.

Muhl said he was sympathetic to the plight of the insurance industry, which had its worst year ever in 1984. He said the Association of Insurance Commissioners expects the industry to sell $67 billion less in insurance this year than last year.

Muhl said he has signed 20 notices of insolvency for Maryland ~~insurance firms this year. Those~~ firms have gone out of business or must stop writing policies because of financial problems.

Insurance industry executives testified yesterday that the industry was in a slump and urged Congress to allow the industry to voluntarily work out the problem. But Rep. George Miller (D-Calif.) chairman

EDWARD J. MUHL
. . . testifies before House committee

gress would be forced to get involved if the insurance industry failed to take immediate action to prevent the closing of thousands of day-care centers.

Insurance industry representatives have said the financial slump was caused by excessively low rates that companies charged during the late 1970s, when they were trying to increase business. They tried to make up the losses through investments, but were hurt by falling interest rates, according to Marvis A. Walter, senior vice president of Insurance Services Offices Inc., which compiles statistics and rate information for the industry.

Because of the financial problems, insurance firms began dropping high-risk industries, and they place the blame on the high awards given in liability cases.

"The potential for multimillion-dollar judgments exists" even though no such award has yet been paid in a child-abuse case, said Frank Neuhauser Jr., vice president of AIG Risk Management Inc., an insurance group based in New York. "Many of us believe we are living under a tort system that is completely out of control."

But J. Robert Hunter, former head of the Federal Insurance Administration during the Ford and Carter administrations, said that the insurance industry is using the courts "as a scapegoat."

"It's a self-inflicted problem, and to take it out on day-care centers is wrong," said Hunter.

Mike Causey is on vacation. The Federal Diary will resume when he returns.

Appendix B JCC 6/18/85

Insurers Told: Exit Some Lines

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Journal of Commerce Staff

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The touchstone for the discussion was a presentation by the Insurance Services Office Inc., an industry-rating and data-gathering service. The ISO estimates that in the next few years the insurance industry will suffer a $62 billion shortfall in capacity. This means that corporate America will not be able to buy all the insurance it needs because insurers ability to cover them will fall short by that amount.

'Anyone who puts his private capital behind lines such as malpractice is putting himself in the hands of a zany judge or jury out in California.'

Mr. Byrne said the industry was responding to these issues in precisely the right way by refusing to cover lines of business that are hostage to court interpretations. "It will be best for the social good to let society know that the problem is not one for the insurance industry but for society as a whole. It is right for the industry to withdraw and let the pressures for reform build in the courts and in the state legislatures," Mr. Byrne said.

He said he saw little hope for reform in such things as the federal program for Superfund, a toxic waste cleanup measure. He said the vast amount of money thus far spent by Superfund was to "educate lawyers on how to refine their suits brought on the part of plaintiffs against industry.

"Anybody who leaves his private capital where the courts can grab it has not done the right thing for his owners," Mr. Byrne said.

On a related score, Thomas A. Greene, president of his reinsurance brokerage firm in New York, said that still more pressure would be brought to bear on the American property and casualty industry by underwriters at Lloyd's of London. Mr. Greene said that beginning in 19[illegible], Lloyd's syndicates would "simply not write reinsurance for the American casualty industry, especially in the lines mentioned by Mr. Byrne." He said further that reinsuring underwriters would virtually dictate to the ISO about a proposed commercial general liability form. He said the domestic reinsurance industry will not write treaties unless the industry adopts the new CGL form.

As to the stability of the insurance companies suffering through this trying period, at least one of the actuaries said that current measures of company solvency used by the National Association of Insurance Commissioners were less than adequate.

[illegible]vin M. Ryan of the National Council of Compensation Insurance urged the actuaries to model industry solvency judgments on a study done by the Aetna Life & Casualty Co. a few years ago.

Aetna studied the financial data of companies that had actually failed and the resultant ratios were absolutely realistic, Mr. Ryan said.

(1)

Insurers Urge Adoption Of New Policy

By JAMES NOLAN
Journal of Commerce Staff

CHICAGO — The very fate of the American liability insurance industry hangs on state regulatory approval of new liability insurance forms.

An array of insurance industry spokesmen argued this position in public hearings Thursday before a panel of insurance regulators from 10 states.

The industry representatives predicted [illegible] eral liability form for use by Jan. 1, [illegible].

The hearings were organized by Illinois, New York and Texas insurance commissioners after a meeting of the National Association of Insurance Commissioners in Kansas City in June.

The commissioners at that time said they felt they wanted to hear from the industry in a single presentation, rather than taking testimony on a state-by-state basis as is usually the case when insurers seek approval for a new policy form.

Illinois Insurance Director John E. Washburn, chairman of the regulator panel, grouped supporters of the new policy in the morning and afternoon session.

Opponents, such as the Risk and Insurance Management Society, the voice of corporate insurance buyers, were to present their case later in the day and continue this morning.

Speaking in support of the new policy John C. Morrison, a senior vice president of Cigna Corp., said the use of the new commercial general liability policy drafted by the Insurance Services Office, an industry policy-making group, "will help to forestall a very serious threat to the financial solvency of some members of our industry.

"Without approval of the new ISO program, there will likely be an unacceptable number of insurer insolvencies — and this problem could have disastrous consequences for the general public."

The ISO in a statement said the industry's existing "occurrence" policy would be replaced by a "claims-made" version.

An occurrence policy covers the insured for injury and property damage that happen during the policy contract year.

The claims-made policy covers the insured only if a claim is made for the damage during the year the policy is in force.

Christopher C. Mansfield, vice president and general counsel, Liberty Mutual Insurance Co. said that "unless we act positively, our industry may not be able to provide the risk shifting and loss distribution capacity which our customers require and society demands."

Fred R. Marcon, ISO executive vice president and chief operating officer, said, "There has been a complete breakdown in confidence on the part of risk takers: confidence in the predictability of loss, the efficacy of the underwriting process and the ability of insurers to control their own financial destiny."

Supporters of the new policy were united in placing the major share of the blame for the crisis on the judiciary system.

Industry officials say almost with one voice that it is the courts redefinition of policy contract language that has led to awards in pollution liability, product liability and medical malpractice that are bankrupting liability underwriters.

Gerald Wakefield, chief executive, North American reinsurance division of C.T. Bowring & Co., presented the views of Lloyd's of London reinsurers, vigorous supporters of the new policy.

Mr. Wakefield conceded that Lloyd's cannot dictate to American [illegible] not approved, Lloyd's will [illegible] American liability underwriters.

"Worldwide reinsurance capacity at this juncture is so short that further erosion could cause a fundamental change in the fabric of the U.S. insurance industry's mode of operation." He concluded: "ISO's proposed new claims-made form certainly goes a long way toward the retention of such reinsurance market support which currently looks so tenuous."

The industry spokesmen returned to the hearing table later in the day for questioning by the insurance commissioners.

Claims Made Vs. Occurrence

Journal of Commerce Staff

CHICAGO — The casualty insurance industry and its biggest customers, corporate America, are having problems with words.

Three words in particular.

The words occurrence and claims made refer to that most important facet of the insurance business, the payment of claims and the question of who will make the payment.

To put it as simply as is possible, no small thing in a sea of policy language complexity, when you buy an occurrence insurance policy, your claim is good for damages you sustained in the period for which you paid the premium, usually one year.

You may not discover the damage until years later, but still your claim is valid and the underwriter who sold you that occurrence policy must pay the claim.

If you bought a claims made policy, your claim is good only if you file the claim during the [illegible] in which the policy contract [illegible]

So if you are a doctor or make your living by making anything from cookie tins to insect spray, you most assuredly want that occurrence coverage. Who knows what you did 10 years ago to lay yourself open to a claim?

Now we get to the sticky part.

It is the occurrence policy and the way law courts are defining the words therein that is bleeding the casualty industry white, industry leaders say.

The insurance industry, therefore, wants to sell only claims made coverage beginning in January 1986.

In the process, the coverage afforded by the occurrence policy as it is understood by the corporations who buy it would be no more.

Understandably, then, the Risk and Insurance Management Society, the voice of insurance buyers for America's corporations, is to a man opposed to the new forms.

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New Liability

By JAMES NOLAN
Journal of Commerce Staff

CHICAGO — Major state insurance regulators were openly skeptical last week about the property/casualty industry's plans to use a new commercial general liability standard policy form.

In hearings convened by the Illinois Insurance Department, regulators from New York, Texas, Connecticut and Illinois said time and again that the insurance industry seems intent on reducing the amount of liability coverage corporations could buy beginning in January.

Further, the regulators argued with industry representatives during three hours of intense questioning that the proposed policy was much too complex for corporate insurance buyers to understand.

More than a dozen industry representatives countered with arguments that the new policy form was an absolute necessity for the survival of the industry.

The burden of the industry's case was carried by delegates from the Insurance Services Office, the industry-funded policy-making body, which has fashioned the new policy forms.

All of the industry arguments ran the thread that casualty underwriters have been suffering catastrophic losses in recent years.

A Lloyd's of London delegate who flew over especially for the [illegible] [illegible] U.K. industry was permitted to adopt the new form, the Lloyd's [illegible] that would [illegible] American underwriters [illegible] action would severely [illegible] the U.K. industry's [illegible] [illegible] [illegible] officers [illegible] and the [illegible] with [illegible] [illegible] lost [illegible] tens of thousands more loss than a year ago.

Lloyd's has had a substantial position [illegible] in supporting American primary underwriters with reinsurance for product liability, pollution and environmental [illegible] coverages, directors and officers liability and medical and other professional malpractice coverages.

The industry forum was organized by commissioners from Illinois, Texas and New York. They were joined by commissioners and staff regulators from 14 other states after they found they were reacting in a piecemeal fashion to pleas from the industry, state by state, for permission to adopt the new system.

Although the commissioners protested that they were open minded about the issues, their questioning showed mounting skepticism.

For example, Peter Gillies, Connecticut commissioner, said that traditionally the industry position on a new policy filing has been that policy contract language is virtually cast in bronze and should not be changed.

"The purpose of this whole exercise is to avoid litigation. But aren't we going to just march lock step into court on this issue?" Mr Gillies said.

"When the industry does not want us to approve something in a policy form the argument is made that if you change it, we will have to go and litigate. And you know what this means in the courts, so for God's sake, don't do that to us.

"Now you are asking us to approve a form which is going to make some very dramatic changes in a whole host of areas. How do you avoid the courts?" Mr Gillies said.

Richard Savage of the ISO said that the danger of litigation was lessened because the new contracts were worded most carefully.

To put the kindest face possible on the matter, the response drew laughter from the regulator's table.

Later, Fred R. Marcon, ISO executive vice president, conceded that the possibility of new litigation had been much on the mind of those who [illegible] the new form. But, he added, the property/casualty industry has no other course if it is to survive.

At another point, Gerald H C Wakefield, chief executive, North American reinsurance division of C.T Bowring at Lloyd's of London, employed an extended anecdote to explain the genesis of a legal liability principal.

He said that a British court had ruled in the days of Queen Victoria that if a householder was [illegible] enough to keep a tiger in the back garden, the householder was liable for damages the tiger did when he got out.

At a later moment in the proceedings, Mr Wakefield sought permission to address the panel on a point.

"Fine," said James P Corcoran, New York insurance superintendent, "but, please, no lions and tigers."

Outright hostility to the new policy forms was repeated at the meeting by a delegation from the Risk and Insurance Management Society, an organization of some 4,000 corporate insurance buyers.

William Blick Jr. of the Allen Group, a New York auto parts maker, and spokesman for the society, said the group stood fast on the position it took in public hearings before the New York Insurance Department in May.

The society then accused the ISO of "an abuse of the antitrust exemption [illegible] by the McCarran Ferguson Act," and that the new policy had been fashioned "with little or no concern as to the impact these changes will have on the insured or potential claimants."

UCC
[illegible]

APPENDIX C

STATEMENT OF THE AMERICAN INSURANCE ASSOCIATION

BEFORE THE

HOUSE SELECT COMMITTEE ON CHILDREN, YOUTH AND FAMILIES

CONCERNING

CHILD CARE AND INSURANCE

JULY 30, 1985

American Insurance Association

The American Insurance Association is a national trade organization of casualty insurers

(1)

The American Insurance Association (AIA) is a trade association which represents 172 property and casualty insurance companies. The member companies of the Association provide a majority of the commercial line insurance coverages written throughout the United States. Some of AIA's members provide general liability coverage to professional day care centers. Liability insurance is provided to some family day care homes through the application of the "business pursuits" endorsement which removes the business exclusion from the homeowner's policy.

Professional day care centers and family day care homes are currently experiencing a liability insurance availability and affordability problem. To the extent that state law mandates the acquisition of general liability insurance coverage as a prerequisite for doing business, the availability/affordability situation is exacerbated. Current insurance market conditions for professional day care centers suggest a market in transition rather than chaos. The countrywide experience for those companies reporting premium and loss data to the Insurance Services Office, Inc. (ISO) for advisory ratemaking purposes for day nurseries appears to conform with the current loss experience for the majority of commercial insurance lines. If expense factors are built into the loss and loss adjustment data for day care nurseries provided by ISO. the combined ratio approaches the aggregate general liability combined ratio of 152. Although these losses clearly indicate the need for increased rates, they do not suggest that insurers should abandon the market.

Insurance availability and affordability problems are not confined to the day care industry. Societal litigiousness and our legal system's movement

Appendix C (Con't)

"The day care facilities have been caught up in this availability crunch and are being deemed higher risk, not necessarily based on a claims experience but due more to an insurance hysteria . . ." Testimony of Edward J. Muhl, Insurance Commissioner of the State of Maryland, before the House Select Committee on Children, Youth and Families, July 30, 1985. The Commissioner went on to point out these statistics for Maryland, remarkable action by many companies given the lack of statistical justification for such a move:

> Of 28 insurers writing liability insurance for day care centers in Maryland last year, 15 have left the market. Of the remaining 13, six will not write any new business. The last 7, those who will write new business, all have excluded child abuse from their policies. The Maryland Commissioner of Insurance has termed the pull out "hysteria" since no data supports it.

Mr. FLORIO. Let me thank both of you.

Mr. Hunter, let me play the devil's advocate because I am a bit confused by your theory and wanted to see if I understand it, first of all. I think it is important.

First of all, let's put aside the conspiracy theory approach for a moment, because one of the things you seem to be saying in your explanation, your theory that it was inherent in the way the insurance industry currently operates, are serious problems that are almost beyond the current capability to be addressed, the current capability of anybody who is in charge of the situation to be addressed.

As I understand it what you are saying is at the top of the peak on your charts, the insurance business is sufficiently lucrative that there are more competitors coming in to compete for the benefits out of the profitable business, to such a degree that conservative pricing on premiums sort of goes out the window.

Mr. HUNTER. Particularly in commercial lines, yes.

Mr. FLORIO. You use the term cash-flow accounting.

Mr. HUNTER. Cash-flow underwriting.

Mr. FLORIO. Cash-flow underwriting. Excuse me.

You use the MGM example, I suspect, as an example of how the desire for the premiums was so great that even fixed determined loss did not prohibit people from writing insurance on the basis of the need to get the premiums, presumably for investment purposes.

Mr. HUNTER. That's correct.

Mr. FLORIO. That loss experience was not a major concern.

Mr. HUNTER. That's correct.

Mr. FLORIO. One of the things I'm confused about is that if there is so much competition, and inappropriate competition that you and I and others have talked about—and you said something today about violations of the antitrust laws which seem to provide for inadequate competition—I'm confused as to how you reconcile too much competition and the thought that it has traditionally been a principal point of criticism of the industry that there was not sufficient competition in the industry?

Mr. HUNTER. Let me explain what happened in this latest cycle.

First of all, you have to look at personal lines and commercial lines separately. The personal lines I call my auto insurance, your auto insurance, homeowners, and so on. The commercial are the accounts that are priced for the bigger, corporate accounts.

There is intense competition for big dollar cash flows, the big corporate accounts, when investment yields are high because of two reasons. The business insurance dollar is a bigger dollar, and, if they can get it, it is sort of a plum.

Second, the commercial risks have alternatives available to them. They can go and self insure. They can create an offshore ~~captive insurance company~~. And they began to do that. When profits go up this high (in 1981), they begin to bail out of the private insurance market and create self-insurance trusts and the like.

The private insurers don't like to lose that business, and they will actually sell below cost even, sometimes. And that is what drove this down.

Some of that was funded by a cross subsidy because they were collecting too much money from you and me, the small accounts.

Mr. FLORIO. That below cost pricing appears to be, under your thought, the cause for the problem that occurs later in the cycle.

Mr. HUNTER. That's what drops the profit.

Mr. FLORIO. It is interesting. I am reading this 1985 review of the Insurance Services Office, and they appear to agree with you in saying the conclusion is "the property/casualty industry must accept the major responsibility for its current financial condition. But, the brutal price war of the last 6 years is over. The industry has finally realized that a business cannot indefinitely price its product below cost and expect to survive."

Mr. HUNTER. I read you an example of the $105,000 risk that went for $5,000. That is a tremendous price cut. But, I can tell you I cannot find one example of an auto insurance risk that used to sell for $105 being priced down to $5, or being priced down at all.

So, the competition that existed occurred on the big accounts. The little people still have rate bureaus, they still have all the other anticompetitive practices; vertical price fixing because of the antirebate laws and the like.

Mr. FLORIO. So in a sense you are saying there is too much competition in the commercial areas——

Mr. HUNTER. And too little for your dollar and mine.

Mr. FLORIO. Where commercial insurers are really capable of taking care of themselves.

Mr. HUNTER. As a matter of fact, we, the little group, are helping fund the price cuts for those big giant companies. The front pages of the Wall Street Journal—if I can find the article for you—pointed out there is this cross subsidy effect.

Mr. FLORIO. Let me ask you a question with regard to proposed banking deregulation initiatives that are coming around which, of course, would provide, if they were to go into effect, the opportunity for other insurance financial services components, to get into insurance. I know some of the banks we have heard from who want to become involved in insurance.

Do you see those entities as coming in to provide for more insurance competition where insurance competition is not needed, or more insurance competition in the areas of the personal lines——

Mr. HUNTER. I don't think the banks want to come into the commercial lines account. I think they want to come into the personal lines area because it is the type of thing tellers can sell, the commodity type of insurance. The auto policy, homeowners policy.

Mr. FLORIO. Would you regard that under your theory it is a healthy development?

Mr. HUNTER. Very healthy. I have testified in favor of bank entry. If Dan McNamara of ISO is correct and we are going to have a $68 billion shortfall of surplus—something I reject as totally impossible, there has been an $8 billion rise in the surplus of insurers in the last 12 months already—they will probably tell you they have had a decline in surplus. But their year ended June 30, 1985, data shows an $8 billion rise in surplus in the property casualty insurance industry.

Mr. FLORIO. Cash-flow underwriting, which you told me the industry even acknowledges as the cause of the problem, how does that take place within the regulatory system?

How is it that people—I know theoretically we have State systems that are supposed to prevent overpricing. I would think that there might be some sensitivity to underpricing if it is going to result in major problems for the industry down the line as we appear to see currently.

Mr. HUNTER. Well, there is little will to stop excessive pricing and there is less will to stop prices that are too low. It is pretty hard for a regulator to come in and say you have got to raise prices. It just doesn't happen. Even though the law says they have to do that.

They don't do it either way. Essentially the regulatory regime is really sort of a Maryland S&L situation waiting to happen.

Mr. FLORIO. In other parts of our jurisdiction in this committee, for example railroads, we call that predatory pricing when someone comes in, underpricing below cost so as to capture the competition in the railroad industry or whatever.

Is that concept radically different in the insurance industry? Wouldn't you call cash-flow actuarial underwriting predatory pricing?

Mr. HUNTER. Of course. Of course it was.

Mr. FLORIO. And what you are saying is that it currently is either not illegal or it is not monitored.

Mr. HUNTER. It is illegal. Prices in every State must be adequate.

Mr. FLORIO. Let me just ask one or two questions to Mr. Nader.

This committee a couple of years ago passed a risk retention proposal in the product liability area. Do you have any experience with whether that is something that has been helpful in terms of—I suppose it has only been helpful to business people, large business people who have the capability of coming together and self insuring?

Is there any need to expand that concept under the current crisis that we are in?

Mr. NADER. Well it has been helpful as a last resort, but you see product liability premiums moderated after about 1981 according to the trade journals at least, who reported on it. So that the risk retention option is always there for companies who want to pool and self insure.

Mr. HUNTER. It is limited however to product liability insurance, and——

Mr. FLORIO. Well my question is, should we be expanding it?

Mr. HUNTER. I think you should look at that. There is no question that that is an option that would be helpful, because—historically insurance companies have started out as groups of people who couldn't get insurance, getting together and forming. That's why you have names like Lumbermen's and Druggists', those kinds of names.

Mr. FLORIO. But this is commercial interests. I would not be of great value, I would think, to day care centers.

Mr. HUNTER. It could be. If you have a million family day care centers, if they could self insure their risk together, you have got a very large pool.

They can't because they run afoul of the State antigroup laws. If you passed a day care center bill in the risk retention area, if you

expanded it to include day care centers, then they could get together and form a national pool. They can't do that today.

Mr. NADER. See, what he is referring to, Congressman Florio, is that in most States it is unlawful under State law for a group of homeowners in a neighborhood to buy as a group and save money in their homeowners' insurance.

Mr. FLORIO. There are a number of States where that has been changed for specific groups. In my own State, the medical society has come forward and they now insure themselves.

Mr. HUNTER. There are still over 30 States though that refuse to allow groups to form in the property casualty area.

Mr. NADER. 37 States.

Mr. FLORIO. Let me yield at this point to the gentleman from New York.

Mr. LENT. Thank you, Mr. Chairman.

I just wanted to follow up a little bit where I am somewhat confused by Mr. Hunter's testimony, because you said at one point that insurance companies are conducting a raid on America's pocketbooks. And then in another part of your testimony, you seemed to indicate that the insurance companies weren't charging enough for premiums and ought to raise their premiums—I think you said 5 percent.

Mr. HUNTER. That's correct.

Mr. LENT. And there's some question whether 5 percent would get them out of their hole.

What is your testimony?

Mr. HUNTER. My testimony is this. They need currently a 5 percent, probably plus, inflation type of rate change.

Mr. LENT. So you are recommending an increase——

Mr. HUNTER. Roughly 8 percent.

But what they are doing is 500 percent, 1,000 percent—9 percent already in the first 6 months on auto insurance alone. They have gone way beyond what is needed. And that is why the stock market has skyrocketed, and if we come back here next year you are going to see a profit number up higher than this paper [indicates chart on profits]. That's what is going on.

Mr. LENT. Other witnesses are going to testify, as I understand it, this morning, that the insurance industry's pretax operating income, which is a combination of the investment income which Mr. Nader referred to earlier, and the underwriting result before application of carry forward tax credits, is a negative $3.8 billion for the year 1984.

Are you familiar with that figure?

Mr. HUNTER. Yes, I am.

Mr. LENT. Do you agree with that figure?

Mr. HUNTER. If you accept their reserves, which is a rather large leap of faith since they increased them so significantly, that would be the answer.

Now that is not what they actually paid out. Don't forget that. That is because of the weird tax laws that are on the books and so on. They are allowed to deduct as if current, all their losses going out into all future times.

That 3.8 is conservative statutory accounting, including accepting their reserves. And it says, "if we stop doing business now and all

the losses had to be paid immediately, day one, yes, we would have lost 3.8 billion." But that isn't what is going to happen, of course. They are going to pay those out over several years.

Mr. LENT. So we agree then—you agree with the industry on the statistics—that there was a $3.8 billion loss for the industry in 1984 including the investment income?

We all know that usually when income comes in and makes the underwriting loss into a net profit——

Mr. HUNTER. I agree that is their number. GAO has a slightly different number. GAO sh :v a slight profit.

Mr. LENT. And you say also, if I understand you correctly, Mr. Hunter, that that loss was something that the companies conspired to achieve.

Is that correct?

Mr. HUNTER. No, they are conspiring to achieve a huge profit next year, sir, and they let things get out of hand because of their cash flow underwriting.

But it is not a tort law crisis.

Mr. LENT. You say they let things get out of hand. You mean they achieved a loss?

Mr. HUNTER. They did not. They have a profit; 3 percent rate of return, net worth.

Mr. LENT. Do you agree that we had——

Mr. HUNTER. I don't agree with your numbers, sir. Because your number doesn't include taxes. It is not a bottom line number. And GAO has a different number.

Mr. LENT. Pretax operating income is, is it not, a combination of investment income and underwriting results before the application of taxes, or even tax credits, is that correct?

Mr. HUNTER. It doesn't even include the rate of return on the surplus.

Mr. LENT. Well, it includes the return on their investments.

Mr. HUNTER. Not on the investment of surplus.

Mr. LENT. OK.

Mr. HUNTER. They did not lose money last year, if that is your point.

Mr. LENT. All right. We will have some other witnesses on that a little bit later on.

Mr. HUNTER. GAO says they did not lose money, even on that basis.

Mr LENT. On page 2, you say that Lloyds of London has stated that it will not reinsure American liability underwriters unless a new policy form is adopted by the State regulators.

My question is, Do you believe that this has any relation to the fact that the insurance industry's combined ratio has steadily worsened over the past 5 years?

Mr. HUNTER. I have no idea why Lloyds wants a new policy form. I don't understand the question.

Mr. LENT. Well, Lloyds must want a new policy form, and has indicated they are not going to reinsure American liability underwriters, because American liability underwriters are having problems. Otherwise they would be happy to reinsure.

Mr. HUNTER. You will have to ask Lloyds why they are doing it. I don't know what it is.

Mr. LENT. We unfortunately, or fortunately, we don't have jurisdiction over Lloyds. But I am sure as an insurance expert you would acknowledge that Lloyds has a pretty good reputation in the field.

Mr. HUNTER. They are venerable. But they are getting less venerable all the time. They have had a series of very bad scandals. And they are not subject to any review. There is no way to check their numbers, even.

Mr. LENT. Let me just go on.

So you don't believe in Lloyds either. You think they are part of this conspiracy to lose money?

Mr. HUNTER. Absolutely. I think they are a part of what is going on in terms of a conspiracy to try to attack the tort law in this country without proving the case.

Mr. LENT. OK.

Now let's turn to the citation in your testimony, the successful Federal Riot Reinsurance Program as an example of how a Federal reinsurance program such as you advocate, ought to work.

Can you tell us when the first policy was issued by that program, and how much premium was collected altogether, the Federal Riot Program?

Mr. HUNTER. You mean for the whole history of the plan?

Mr. LENT. Yes.

Mr. HUNTER. The first policy was issued, I believe, in 19—the law passed in 1968.

Mr. LENT. 1969.

Mr. HUNTER. The first policy would have been 1969. And it was a binder premium of, I think, $1.25 per thousand.

Mr. LENT. It was about $125 million that was raised through that premium. And we know—or perhaps you can tell us how many claims were made against that program, and how much was paid out?

Mr. HUNTER. I don't recall exactly, because losses have been paid since I was Federal Insurance Administrator.

Mr. LENT. Well there were very few riots.

Mr. HUNTER. Very few losses.

Mr. LENT. Very few riots.

Mr. HUNTER. Very few day care center losses, too.

Mr. LENT. And very few claims.

But, what happened to that money?

Mr. HUNTER. That money was used by the Federal Government for current—my recollection—crime insurance claims payments.

Mr. LENT. That's right. It was used by the Federal Crime——

Mr. HUNTER. But it was accounted for, and even the investment income was accounted for, for the purpose of belonging to the reinsurance program.

Mr. LENT. That was another Federal program, the Federal Crime Insurance Program, was it not?

Mr. HUNTER. It was.

Mr. LENT. Do you know how much was collected in premiums——

Mr. HUNTER. Oh, I know that lost quite a bit of money. But it had to, because the Congress in its wisdom required it to have affordable rates.

Mr. LENT. So the Federal Crime Program, which you did not refer to in your testimony, lost money admittedly.

Mr. HUNTER. It had to. That was the way you designed it.

Mr. LENT. It used the money from the riot program to pay the losses on the crime program.

Mr. HUNTER. That was a decision that was approved by the Congress.

Mr. LENT. Now, what about the Federal experience with the Flood Insurance Program? Have we made money or lost money on that?

Mr. HUNTER. You have lost it because Congress required a subsidy.

Mr. LENT. Right.

And how about the Crop Insurance Program the Federal Government runs, did we make money or lose money on that?

Mr. HUNTER. You see, all these programs——

Mr. LENT. Answer that question.

Mr. HUNTER. My recollection is that the Crop Insurance Program, which I did not administer, lost money.

Mr. LENT. Well, I am not saying that you administered or you didn't administer it.

Mr. HUNTER. The others I administered, so I am more familiar with the statistics. My recollection on the Crop Insurance Program, Mr. Lent——

Mr. LENT. They all lost money.

Mr. HUNTER. No; the Riot Reinsurance Program made money.

Mr. LENT. OK. Because there were no riots.

Mr. HUNTER. Because you required self-sustaining rates. That's the only time Congress required self-sustaining rates.

Mr. LENT. These other programs, Crime, Riot and so forth, are property programs, is that correct? In other words, they pay for actual loss to physical property as opposed to bodily injury claims?

Mr. HUNTER. That's correct.

Mr. LENT. Now, the Federal Government has participated in one liability indemnity program; a program that was made necessary because the insurance industry was unwilling to provide insurance to the manufacturers of the Swine Flu vaccine.

Do you recall that?

Mr. HUNTER. I do.

Mr. LENT. You may have had something to do with it, I don't know. But, you are familiar with the program?

Mr. HUNTER. I participated in the program.

Mr. LENT. What happened to that program?

Mr. HUNTER. It lost money.

Mr. LENT. Does it sound correct if I tell you 4,166 claims were filed, of which fewer than 700 have been settled; some 129 lawsuits are still pending 10 years after that program was established and the immunizations ended?

Mr. HUNTER. I believe those numbers.

Mr. LENT. Would it be reasonable to you if I said that a total of $83 million had been paid out to claimants as of July 1, 1985, and no premiums were collected, so it lost money?

Mr. HUNTER. I would say that is right.

Mr. NADER. Lost money the way the Department of Defense loses money. It was the Government's fault. They had to pay out. They were to blame.

Do you say the Defense Department loses money?

Mr. LENT. We are not having a hearing. This isn't the Armed Services Committee. That is another day. You save that for later.

But what we are talking about here is the experience of the Federal Government in running insurance programs.

Mr. HUNTER. All these programs—you didn't even collect a premium in swine flu—all these programs were designed, except the Riot Reinsurance Program, were designed to lose money. Congress said the Riot Reinsurance Program had to be self sustaining, and in fact it made a profit. Every other one Congress—now you have got to ask yourself, why did you write the laws those ways. Every other one were designed to lose money and it did. So you got what you wanted.

Mr. LENT. Well, would you expect a Federal reinsurance program such as you advocate, to be funded by general revenues, or would premiums be collected?

Mr. HUNTER. There would be premiums.

Mr. LENT. OK. How would they be collected?

What would you do to ensure that the program takes in enough money each year to pay for these bodily injury and liability claims that might be brought off in the future.

Mr. HUNTER. Same way you do with any reinsurance program. You actuarily calculate the needs, you adjust over time. With a long-tail line actually it is easier because you are going to be in the reinsurance business for many years.

Mr. LENT. But when we did that for the Swine Flu Program, we didn't have any way of knowing of the $83 million——

Mr. HUNTER. I can tell you one thing, zero is not enough premium. I'm an actuary, so I am sure of that.

Mr. LENT. Well, it was never anticipated that—by the figures that were given to the Congress at the time that program was set up, $83 million——

Mr. HUNTER. Believe me, Mr. Lent, zero was not enough premium. We knew that when we did the program, because I was there.

Mr. LENT. OK. You say you have a draft bill and you have submitted it. I wonder if you would be good enough to submit it to the minority staff.

Mr. HUNTER. Surely.

Mr. LENT. In that draft bill, what agency would be authorized to provide this standby insurance authority.

Mr. HUNTER. We have proposed the FTC.

Mr. LENT. The FTC?

Mr. HUNTER. Yes.

Mr. LENT. Mr. Chairman, I have no further questions.

Mr. FLORIO. Let me just ask a followup question.

The Swine Flu example—and I recall that vividly—my recollection was that the manufacturers of the vaccine, in the face of the Swine Flu epidemic which was supposed to come, said they were not going to produce the vaccine any more unless the Government became involved in insuring against claims.

Mr. HUNTER. That's true.

Mr. FLORIO. Refresh my recollection. Were there premiums that were charged against the Swine Flu manufacturers, the vaccine manufacturers?

Mr. HUNTER. I'm sure the insurers must have had some premiums in their general liability policies.

Mr. FLORIO. Why didn't underwriting take place to anticipate the claims so as to make the system solvent in terms of premiums that would deal with the anticipated claims?

Now, admittedly you can't be sure, but the experience has not been a good one.

Mr. HUNTER. Of course this was a one-shot deal. With day care centers we are talking about an ongoing basis, year after year. If you were reinsuring day care centers, for example, you wouldn't expect to just reinsure them for just a few months. You would be reinsuring them over a long period of time. If things started to deteriorate you have a million exposure risks, so you have large numbers.

With Swine Flu you were dealing with a lot more unknowns. With day care center it is much more predictable.

Mr. FLORIO. We are talking about reinsurance to deal with the extraordinary risk potential, if there is one, of child abuse.

Assume the industry's position is, they would say they can't evaluate the risk, and therefore are lumping the potential risk into the ordinary risk, which doesn't appear to be great, of running a day care center. That is why they are having high rates.

We talked about a Federal reinsurance system.

Is there someone that has the capability of evaluating the potential risk of child claim, or child-abuse claims?

Mr. HUNTER. Surely.

Mr. FLORIO. Then why can't the insurance industry do that?

Mr. HUNTER. They can. But they are choosing not to.

Mr. FLORIO. Why would they not, if there is a potential market there?

Let's assume for a moment, the suggestion is that the risks are minimal and premiums would be whatever, if the risks are minimal why wouldn't the insurance industry be interested in coming in and getting the premium for a minimal risk?

Mr. HUNTER. What I hear on the street is that they are going to come in. And their intention—they don't like these hearings—and their intention is to take care of this day care crisis because they have admitted on the record in the other committee that there is no statistical justification for this position. and the risk is calculable.

And if you really have a 20-year latency period, let's call it, for when an abused child might sue, you have also got 20 years use of the money. They don't talk much about that. That 20-year use of the money is worth a lot of money.

Mr. FLORIO. Does that go to the point about the $3.8 billion loss? That is a loss that is here today that is to be paid out over a period of time.

Mr. HUNTER. It is a loss, it is a hypothetical, really, because they still have the money. Who else says I just lost money and still has it? There is a famous chapter in Andrew Tobias' "Invisible Bankers" that says—a very short chapter on insurance accounting, how

to take in $50 billion, pay out $3 billion and declare a loss. That's what is going on.

Mr. FLORIO. Your thought on this whole question—maybe just to sum up—is that the insurance industry is in need of some revenue income through more appropriate pricing of their premiums in a sense to compensate for the underpricing that has taken place in recent past. That underpricing took place so as to get premiums in for investment income purposes, particularly when interest rates were high—which they are not now, relatively speaking. And that the industry is going beyond reasonableness in obtaining premium increases to meet their needs, their profitability needs, and is using the dilemma that we find ourselves in to ask for more than is required to make them profitable and solvent.

Is that——

Mr. HUNTER. Particularly in the commercial lines. But even generally across the board on consumer lines. The auto insurance price rise is beyond what is needed.

Mr. FLORIO. And I suppose my dilemma—and I suspect our dilemma here—is that we are going to hear from the other side, and there is going to be an effort to say, I suspect from reading the testimony, that liability awards are the paramount cause of the dilemma, and that the public agency responsibility overseeing the industry and to find out who is correct—and it may very well be that everyone is a little bit correct--there may be some need for dealing with insurance liability—and the public capability is just not impressive in the current way that we evaluate the insurance industry.

Mr. HUNTER. Even the insurance industry has expressed concern over the lack of capacity of the Federal Government to understand insurance. Andre Maisonpierre, who is here in the room, has been so quoted.

Mr. FLORIO. I was planning on bringing this up later, but I think it is just a startling change in theory. The gentleman, Mr. Morton from the John Hancock Mutual Life Insurance goes into some detail, if he is quoted correctly, in saying that Federal regulation of insurers is needed to take out some of these peaks and valleys in the insurance industry.

Mr. HUNTER. State Farm has for years suggested that the antitrust laws should be changed. There is a movement in the industry to understand that State regulation is not necessarily the best of all possible worlds.

It is not the worst, either. If you had said to me, restructure it, I wouldn't get rid of State regulation either. Local complaint handling is good, for example. Better if it is left there. Information dissemination should be there. Data processing, review of financials—these are multinational, billion-dollar corporations—should be at the Federal level.

Prudential is regulated by your State. Prudential has more assets than any other corporation in the world. It took about a week's cash flow and bought Bache. It just didn't pay bills for a week and bought Bache with what they had left over, literally.

And that is the kind of companies you are dealing with. And they are transferring money electronically all over the world; in and out of States, in and out of countries. And you are saying to

the State of New Jersey, what are you doing about it? And the State of New Jersey has a couple of PC's and trying to chase them around with it.

Mr. FLORIO. Let me express our appreciation to the two witnesses.

Mr. Nader.

Mr. NADER. I just have one final comment, Mr. Chairman. I hope the committee will avail itself of the diversity of the insurance industry beyond simply hearing testimony from insurance industry trade associations. That the chief executive officers of Prudential. Metropolitan, Liberty Mutual, and many other large companies should be asked for their opinions and judgments as well.

If the insurance industry wants to avoid the taint of collusion or the accusation of collusion, they would do well to send up some individual CEO's here instead of speaking with one voice through their various trade associations. And I am sure Larry Jones would like a respite from his burdensome duties of coming up here all the time.

Mr. HUNTER. One other thing I would like to say, Mr. Chairman, I do appreciate that in your State, New Jersey, there has been an attempt by the insurance department to do some good things in recent days. And they have tried very hard against, you know, fairly sizable odds.

Mr. FLORIO. Let me just respond to that, because I was a bit surprised at the prevalence of the practice of midterm cancellation and changing of terms of contracts. Basic contract law, one would think, precludes unilateral changes in the terms of contracts in the middle of a contract.

So that when I saw it as a great step forward to stop unilateral canceling or changing of the terms of contracts, I was not particularly impressed.

Mr. HUNTER. Believe me, it is way more than is going on in other States.

Mr. FLORIO. Which is kind of a sad commentary on something.

I appreciate your participation today. I thank both of you for your help.

As I indicated to people in the audience at the beginning of our session, we now are required to take about an hour break. The Amtrak legislation is on the floor. Mr. Lent and I are the floor managers of the bill.

But we anticipate being done within an hour. So, we will call a lunch break at this point, an early lunch break at this point and say that we will reconvene at 12:30.

[Whereupon, at 11:15 a.m., the subcommittee meeting was recessed to reconvene at 12:30 p.m. this same day.]

AFTER RECESS

Mr. FLORIO. The subcommittee will kindly reconvene.

As many of you may know, there is a bit of a difficulty on the House floor that the electronic recording system has fallen apart, so they will be taking votes by individual members. It will be a long period of time until we get to the L's. We just finished the F's. So Mr. Lent will be a little bit delayed, but he has asked us, out of

respect for the time of the people here, to go forward with our hearing.

Our next panel of witnesses is comprised of Mary K. McHugh of the American College of Nurse-Midwives; Eunice Cole, president, American Nurses Association; Hyman Aaron Pressman, comptroller, city of Baltimore; Richard Kopke, chairman, ad hoc insurance committee, New York State Association of Renewal and Housing Officials.

Welcome to all of our witnesses.

Statements will be made part of the record. We would ask that the witnesses go forward in a summary fashion.

We will be pleased to hear from Ms. McHugh.

STATEMENTS OF MARY K. McHUGH, CNM, AMERICAN COLLEGE OF NURSE-MIDWIVES; EUNICE R. COLE, R.N., PRESIDENT, AMERICAN NURSES ASSOCIATION; HYMAN AARON PRESSMAN, COMPTROLLER, DEPARTMENT OF COMPTROLLER, BALTIMORE, MD; AND RICHARD KOPKE, CHAIRMAN, AD HOC INSURANCE COMMITTEE, NEW YORK STATE ASSOCIATION OF RENEWAL AND HOUSING OFFICIALS

Ms. McHugh. Thank you, Mr. Chairman, for inviting us here today to talk about the unavailability of liability insurance for nurse-midwives in this country. I am here today with Karen Ehrnman, who is our Government relations coordinator for the American College of Nurse-Midwives.

I have been asked to speak to this committee for three reasons. One is I am really the prototypic nurse-midwife. I was educated after 1970, and I was educated at a master of science level as preparation for midwifery. I am in clinical practice now. I work at a free-standing birth center, which is representing a group of nurse-midwives most affected by the unavailability of insurance in this country.

I am also the chairperson for Pennsylvania for the American College of Nurse-Midwives, and as such, I am very involved at a State level with trying to seek a solution to this problem.

Briefly, I would just like to comment on what the modern nurse-midwife is and what she does.

The nurse-midwife of the 20th century is an expert in the care of normal, healthy women who are going through pregnancy and also those seeking gynecology services. We do not deal with high risk women in an independent fashion. We always work with a clear-cut backup arrangement with an obstetrician or other physician.

We are mainly educated at higher levels of preparation in some of the bigger universities in the country. Presently our organization has 2,500 members, of whom 1,400 had insurance through our master—group—policy last year.

Nurse-midwives are special in this discussion because we are really on the cutting edge of nursing practice in this country. We have moved forward. We have moved into areas which could be called independent practice, and I would like to come back to that term. As such, we are the first people to feel some restrictic like the loss of liability insurance.

I would like to discuss the issue of independent practice for a second, because it can be a red flag that gives people misconceptions. A nurse-midwife never works independently in a clinical sense; however, in an entrepreneurial sense, in a business sense, a nurse-midwife may be self-employed, and this seems to be at the root of some of our problems in getting malpractice insurance coverage.

Some history on the coverage that we have had. Our professional organization since the early 1970's has been able to provide a very affordable, very comprehensive liability insurance package to its members. Through that time period, we did have three carriers. One carrier did not have adequate premiums and we sought another carrier, who then decided not to write any more malpractice insurance, which left us with our carrier for last year, Mutual Fire, Marine and Inland Insurance Co. of Philadelphia.

At the end of the policy year, they made it clear to us that they would not reissue the master policy. When we asked them why, they said because it was very difficult, impossible to find reinsurance to cover us for the million-dollar limits that we needed. It is critical that nurse-midwives have the policy that does get them $1 million coverage because in this country, most hospital privileges depend on having $1 million coverage.

As a national organization, we feel that we have taken every prudent step to find ourselves insurance. We sought a seasoned broker who had a good track record for placing liability insurance. This broker exhausted the market and was turned down repeatedly in his search to find liability insurance.

We then approached the same companies on a personal level, communicating with the company presidents directly. We went with our claims data. We sought to have them change their minds and again were refused. We have been working with the American Insurance Association. They have been helpful in trying to help us find a solution to this problem. We still have no insurance.

At the State level early in the summer, many of us started working. We realized that in general in this country insurance is a State problem. Speaking from my own experience, which parallels the experience in the other 49 States, we have worked with our insurance commissioner. He has written letters for us. We have followed up on the letters. We still have been kept out of the market.

Some nurse-midwives have been able to find a temporary type of coverage. Some nurse-midwives have found coverage through the American Nurses' Association, or through the Nurses' Association of the American College of Obstetrics and Gynecology. Some people have found temporary coverage under a physician plan.

Most of these plans are busy now writing exclusions for nurse-midwives so that sometime within the calendar year, nurse-midwives will be excluded from those plans. Some of the plans that people have secured have practice restrictions that we feel are restraint of the type of practice that we would like to have. For example, it might be a plan that requires employment by a physician.

In summary, one-half of our membership has lost its insurance. We have sought, in good faith, through all of the conventional means, to find insurance for our membership. We feel that our actuarial data proves that we are not a high risk to an insurance

company. We have sources of data that do conclude that only 6 percent of certified nurse-midwives are named in a suit in this country. This is in outstanding contrast to the figures released by the American College of Obstetrics and Gynecologists. Their figures range from 60 to 78 percent as a percentage of suits that obstetricians are involved with.

What we need from you and what we need in the future is some help with communication with the State insurance commissioners. We want them to know that you at the Federal level feel that this is a problem. We have also thought of solutions that involve Federal reinsurance. We are very, very reluctant to get involved with that kind of plan.

We have thought of solutions that involve self-insurance, and we have been told that this is a very unwieldy solution to a problem for a small group of people.

Thank you.

[Testimony resumes on p. 108.]

[The prepared statement of Ms. McHugh follows:]

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Testimony of the
American College of Nurse-Midwives

Good morning. My name is Kate McHugh and I am a certified nurse-midwife (CNM) and chairperson of eastern Pennsylvania's chapter of the American College of Nurse-Midwives (ACNM). Today I am pleased to represent the American College of Nurse-Midwives and the College's 2500 certified nurse-midwife members from across the United States.

Mr. Chairman and Subcommittee members, the American College of Nurse-Midwives appreciates your attention to this urgent problem and this opportunity to tell "our story" to members of Congress, the insurance industry, and to the American public. We believe, after hearing our story, that you will agree with us that the insurance system in America, as it is currently set up, is not working.

Last week several members of the American College of Nurse-Midwives also came to Washington to talk with their own members of Congress about this insurance problem. When an "unnamed" receptionist for a member of Congress was indicating to a health legislative assistant that the certified nurse-midwives had arrived for their appointment, she said, "the American College of Nurse-Housewives are here for their appointment." From this we have concluded that not everyone knows exactly what a certified nurse-midwife is. So, I'll take this opportunity to set the record straight and to get us all thinking along the same lines.

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What is a Certified Nurse-Midwife?

A certified nurse-midwife is an individual educated first in the discipline of nursing who then completes advanced education at schools of midwifery associated with 28 institutions of higher learning, among them Yale, Columbia, Stanford, Georgetown, and many state universities. Upon completion of this educational program, the student is eligible to sit for a national written examination. Only when the exam is passed is this person designated a certified nurse-midwife. Nurse-midwives are experts in care for the healthy woman during her pregnancy, labor and delivery, as well as care for both mother and child after the baby is born.

The term "healthy" in this last sentence is very important for it is one means to distinguish between the care of certified nurse-midwives and that of physicians. Again, nurse-midwives care for normal, healthy women. The term "healthy" probably also contributes to the positive selection process by which clients at low risk of law suits seek out the services of certified nurse-midwives.

In addition, we find that not many people are aware that all nurse-midwives work in clinical collaboration with physicians. We form a team. Written alliance agreements and protocols between nurse-midwives and physician ensure that high quality care is provided to mothers and children.

These agreements and protocols establish mechanisms for consultation and referral when complication arise. ACNM also has reached a formal agreement with the American College of Obstetricians and Gynecologists outlining acceptable guidelines for working relationships.

Finally, approximately 75% of the births attended by certified nurse-midwives occur in hospitals and another 15% occur in free-standing accredited birth centers. And the babies, with a few exceptions, are very healthy. (See attachment A for references about health outcomes of certified nurse-midwives.)

From this discription, you can see that no member of the College is an "ordinary midwife" in the usual concept of that term. Nurse-midwives deliver about three percent of the babies born in the United States each year.

Background on ACNM

The American College of Nurse-Midwives (ACNM) is the professional organization for nationally certified nurse-midwives (CNMs) in the United States. Its 2,500 members represent close to 85 percent of the profession. A full 95% of the members carry some type of malpractice insurance coverage.

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Details of the Current Crisis

Since July 1, 1984, about 1,400 CNMs have had malpractice insurance under a blanket ACNM policy written by the Mutual Fire, Marine & Inland Insurance Company of Philadelphia, Pennsylvania. (The remainder of ACNM's membership have had insurance from their employers - i.e. hospitals, county health departments, and health maintenance organizations.) Mutual Fire notified ACNM in May, 1985, that the policy would not be renewed on July 1, 1985. In addition, in July, Mutual Fire cancelled all policies which had been written after January 1, 1985. ACNM's malpractice insurance was not renewed because of general conditions in the insurance industry (the unavailability of reinsurance) and not because of its members' professional performance. (In general, suits have been filed against only 6% of all nurse-midwives - - a number not considered high among medical professionals.)

History of Insurance Coverage

Since the early 1970s the American College of Nurse-Midwives has been able to obtain for its members a group malpractice policy that would pay up to one million dollars per claim. This one million dollar amount of insurance is the amount which many hospitals require nurse-midwives to purchase in order to qualify for hospital privileges. It is the amount of insurance which we are trying, although

unsuccessfully, to purchase for our members today. Mutual Fire and Inland Insurance is the third insurance carrier the ACNM has worked with in the past three years. This change in companies has been the result of three separate situations: 1) the inadequacy of the premi.m rate charged by one company, 2) the second company's withdrawal from the medical malpractice market, and 3) the nonrenewal of the reinsurance treaties for our most recent policy.

Steps Taken to Obtain New Insurance Policy

Early this year when ACNM received word that placing the master insurance policy might be difficult, we selected a "seasoned" broker with an excellent history of placing professional medical libility insurance. We believed that our broker understood what nurse-midwives are and that he would "market" us appropriately to the insurance industry. In search of a replacement for Mutual Fire we contacted 17 insurance companies in the United States. We were told that this repsented most carriers in the U.S. who write professional liability insurance. To date we have been turned down by all of these companies!

Judging from the letters (and conversations) which we received from these insurance companies indicating that they do not want to write insurance for CNMs, we learned that many insurance companies have simply stopped writing

malpractice policies. We also learned that within the specialty area of obstetrics, a crisis within a crisis is occuring. Insurers are afraid. The increasing number and size of settlements in medical malpractice insurance premiums is causing insurance companies to raise malpractice insurance premiums to astronomical levels -- or stop offering the policies altogether.

We did not stop our efforts after these rejections. Instead, in order to better inform insurance companies about the relatively low risk that certified nurse-midwives would place upon their companies, ACNM made personal appeals to several insurance company presidents. The response was still "no". And, as recently as three weeks ago, the American College of Nurse-Midwives has written again to each of these 17 company presidents asking them to reexamine the decision not to insure nurse-midwives and has offered to review with them the low incidence of claims against nurse-midwives.

In addition the ACNM initiated communication with the American Insurance Association and the National Association of State Insurance Commissioners to facilitate communication between the industry and the nurse-midwives-just in case this lack of insurance coverage was the result of miscommunication. Fortunately, we have learned alot more about the insurance industry and the insurance industry about nurse-midwives. Unfortunately, we still have no insurance.

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State Level Initiatives

We learned that insurance is a state issue and regulated at the state level. We sent nurse-midwives to talk with all insurance companies in their states who write professional liability insurance. The response was still "no". Nurse-midwives talked to governors, state legislature representatives and state insurance commissioners. To date only one state out of fifty -- New Jersey -- has been able to offer insurance from a private carrier.

Still focusing at the state level nurse-midwives learned about joint underwriting authority and lobbied state legislators to extend joint underwriting authority to in-include nurse-midwives. In fact, we have been successful in New York and Texas. However, either the premiums suggested for this type of coverage have been beyond our reach [i.e. New York premium of $73,000/nurse-midwife for births in downstate (New York City area) without a physician on the premises): Nurse-Midwives average salary is $25,000/year)] or the amount of insurance offered has been inadequate (i.e. only $250,000 coverage in Florida). Thus far, the state joint underwriting authority has not yielded positive re-results.

Temporary Insurance Coverage

In an attempt to keep practicing nurse-midwives have been forced to pursue a variety of temporary insurance

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coverages.

- o In some states, individual CNMs have found coverage through an insurer, for instance a physician-owned company, but these policies usually carry practice restrictions and cost many times the rate of group -sponsored programs. In addition, this involves only a handful of CNMs across the U.S.
- o Some CNMs may be covered through their employers. This may not shield them from personal liability therefore ACNM encourages CNMs to carry their own professional liability insurance as well. In addition, ACNM has received information that even some hospital policies are writing in exclusions of CNMs.
- o In some states in which CNMs practice in conformity with the Nurse Practice Act, the American Nurses' Association (ANA) insurance policy will cover nurse-midwives. However, last week we received word that ANA's insurer will also write in an exclusion of nurse-midwives effective November 1, 1985 (see attachment B). This has occurred despite the ANA's opposition to this turn of events and ANA will describe this series of events in their testimony.

- o Some CNMs who are employed by a physician or work in a hospital as an employee can join the Nurses' Association of the American College of Obstetricians and Gynecologists (NAACOG) and subscribe to their policy. However, we have also been notified that effective January 1, 1986 an exclusion for certified nurse-midwives will also be written into this policy.
- o In considering practicing without insurance, most CNMs, as well as most MDs, feel both a moral and practical obligation to protect their patients and themselves from any unintentional human error on their part. In addition, many CNMs must carry malpractice insurance to retain their employment and/or hospital privileges. It is simply not considered viable or responsible to practice without liability insurance.

The Problem

Over half of the nation's certified nurse-midwives have lost their malpractice insurance, and so far no company in the insurance industry is willing to write a replacement policy. In addition, more of the variety of temporary insurance coverages are eliminated by companies writing in exclusions of nurse-midwives.

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This behavior is irrational.

Nurse-Midwives are part of the solution to the problem of high-cost health care. Not only do certified nurse-midwives provide alternative cost-effective care, they also provide an opportunity for insurers to examine a group of health care providers who are in a low risk category according to available claims data and evaluate the determinative factors which lead to this favorable claims experience.

Summary

The insurance system is not working. As a result consumers are being denied the right to select care from many certified nurse-midwives and nurse-midwives are being denied the right to work.

How can you help us?

1) Develop and implement strategies to get the insurance system working again.
2) Consider temporary, emergency legislation which would provide a federally sponsored program of reinsurance. ACNM has identified a few insurance companies which are willing to write insurance for a portion of the total necessary coverage, however, they cannot because of the unavailability of reinsurance (See attachement C.)

Thank you very much for this opportunity to tell our story. I would be happy to answer any questions that you might have.

Attachment A

CONTRIBUTION OF CNMs TO IMPROVED HEALTH OUTCOME

A number of studies have been done which show that care by certified nurse-midwives increases utilization of prenatal care facilities and that such care reduces the incidence of low birth weight, prematurity and neonatal death and reduces the impact of risk factors, to wit:

- In Holmes County, Mississippi, in 1971 the infant mortality rates had dropped from approximately 38 per 1,000 live births to 20 per 1,000 live births, two years after certified nurse-midwives began providing primary care to pregnant women as part of a community-wide focus on the health problems of mothers and babies.[1]

- In a pilot project in Madera County, California, established by special legislation which made nurse-midwives legal for the duration of the project, certified nurse-midwives were introduced as the only new variable in the County's health care system. From January 1961 to June 1963 the prematurity rate dropped from eleven percent to 6.6 percent and the neonatal mortality rate dropped from 23.9 deaths per 1,000 live births to 10.3 deaths per 1,000 live births. There was a significant increase in attendance at prenatal clinics during the pilot project. After the program was discontinued due to the California Medical Society's opposition to legalizing nurse-midwifery, the prematurity rate increased by almost 50 percent and the neonatal death rate for mothers who had no prenatal care almost doubled after the program ended. The neonatal death rate of mothers who began prenatal care in the first two trimesters increased fourfold.[2]

- Between 1976 and 1977 at a clinic for teenagers in Lincoln Hospital in New York City, nurse-midwifery care brought considerable improvement in outcome measures such as maternal weight gain and hematocrit. The rate of low birthweight babies dropped from 18.1 percent to 6.3 percent.[3]

- At Su Clinica Familiar in Southern Texas, where all maternity care for normal mothers is provided by certified nurse-midwives, the prematurity rate in 1974, two years after nurse-midwifery care began, was 3.5 percent. In the same year in Texas the prematurity rate was 7.6 percent and for the nation it was 7.4 percent.[4]

- A study by the University of Mississippi Medical Center between October 1, 1972 and April 30, 1973 showed that nurse-midwifery clients kept 94 percent of scheduled appointments, compared with 80 percent of visits kept by clients of the house staff physicians. It should be noted that clients of both physicians and nurse-midwives[5] did not see the same care providers at successive visits.

CNM's outstanding contributions to the prevention of low thweight have recently been highlighted by three separate groups National Academy of Science's Institute of Medicine,[6] the .thern Governors' Association Task Force on Infant Mortality,[7] and : Children's Defense Fund.[8]

The Institute of Medicine's Report Preventing Low thweight, as part of its emphasis on improved access to en al care, calls for "more reliance. .on nurse-midwives...to crease access to prenatal care for hard-to-reach, often h-ris., groups. This recommendation is based on the studies that icate that certified nurse-midwives can be particularly fective in managing the care o' pregnant women who, be ause of ial and economic factors, are more likely to deliver low birth .ght babies.

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Attachment B

Kirke-Van Orsdel
Incorporated

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September 4, 1985

Mr. Ken Dyer
Controller
American Nurses' Association
2420 Pershing Road
Kansas City, MO 64108

Re: American Nurses' Association
Professional/Personal Liability Insurance

Dear Ken:

I am writing to notify you that the underwriter of the ANA Professional/Personal Liability Insurance plan has decided to exclude Nurse-Midwives from the ANA plan coverage effective November 1, 1985.

The underwriter explained that "all the notice our plan and its applicability to nurse-midwife coverage in certain instances has received is forcing us to file an amendatory exclusion to the policy."

The underwriter has agreed to allow current nurse-midwife insureds to carry coverage up until their individual renewal dates.

Kirke-Van Orsdel will be notifying all current insureds of this change in their premium due notices via a letter and the certificate rider.

All new insureds will be made aware of this change at the time of issuance with a letter from KVI.

I will be working closely with your staff in drafting all notification materials. If you have any comments regarding the wording, please let me know.

Sincerely,

Susan Vickery

Susan L. Vickery

SLV/jz

cc: Ms. Mary Rita Prah, Executive Director, ACNM
Mr. Billy Ellis, Vice President, KVI

A KVI GROUP COMPANY

Attachment C

AMERICAN COLLEGE OF NURSE-MIDWIVES

1522 K Street, N W , Suite 1120, Washington, D C 20005 202/347-5445

Certified Nurse-Midwives Request Federal Relief

The Problem:	Professional nurse-midwives cannot practice without basic malpractice insurance. Despite a low incidence of malpractice claims, insurance companies have made the decision to cancel policies for nurse-midwives, refused to renew exising policies and refused to issue new policies. Whereas a few insurance companies are willing to write insurance for a portion of the total necessary coverage they cannot because of the unavailability of reinsurance.
The Solution:	A federally sponsored program of reinsurance to reinsure a private primary carrier of professional liability insurance for certified nurse-midwives. In addition, the federal government would act as guarantor for excess insurance coverage.
Implementation:	Legislation would be passed to give the Secretary of Health and Human Services authority to negotiate with ACNM a reinsurance program for certified nurse-midwives.
The Insurance:	
Part A	Up to $100,000 coverage provided by private insurer and funded by CNM premiums.
Part B	$100,000 - $5 million reinsurance pool provided by federal reinsurance financed by CNM premuims.
Part C	$5 million - $10 million reinsurance pool provided by federal government and funded by rollover of premuims from part B; in addition, the fund would take advantage of investments on funds in part B. There is very little likelihood of spending any funds from part C.
Temporary Plan:	This insurance plan would be in effect for one year with the option of being extended by the Secretary of Health and Human Services if there is no change in availability of reinsurance from the private market.

Mr. FLORIO. Thank you for a very succinct statement.
We are pleased to have you back, Ms. Cole.

STATEMENT OF EUNICE R. COLE

Ms. COLE. Thank you, Mr. Chairman.

I am Eunice Cole, and I am president of the American Nurses Association. With me today is Thomas Nichols, legislative counsel.

I am appearing today on behalf of the 185,000 members of our constituent State associations with respect to a crisis situation that is occurring in the nursing profession, namely, the unavailability of professional liability insurance for certified nurse-midwives.

First of all, we would like to commend the chairman and this entire subcommittee for the timely manner in which these hearings are being held. This subcommittee has always been a strong advocate for nurses and other practitioners to compete in the marketplace. In its fierce resistance to the proposed professions exemptions from the jurisdiction of the Federal Trade Commission, the subcommittee has indicated its support of open and fair competition in the health care industry.

We come before the subcommittee today to discuss another major threat to competition. The insurance industry's decision to withhold liability insurance from certified nurse-midwives has altered their ability to practice, and provide quality health care services.

The actions of the insurance industry will have the effect of denying access to consumers who use the services of nurse-midwives and will thwart needed competitive forces in the market for obstetric services.

We must come before this subcommittee to seek relief from a crisis that threatens the viability of the practice of nurse-midwifery and potentially the ability of all nurses to practice in the community setting.

Studies have shown that patients who have been cared for by certified nurse-midwives are satisfied with their care. Nurse-midwife services have been documented to decrease the incidence of low birth weight and infant mortality. Nurse-midwives have reduced financial barriers to care. Furthermore, they provide quality care at lower cost than physicians and reach women and infants of all socioeconomic levels, especially those who are in the high risk population category.

By offering a lower cost alternative, nurse-midwives help to alleviate inflationary pressures in the health care industry.

We urge the Federal Government to encourage providers like nurse-midwives to market their services in order to increase competitive forces in the industry.

The Reagan administration and the Congress have been effective in increasing competition in health care. Nurse-midwives have and can continue to facilitate such an effort.

Mr. Chairman, you have heard from the American College of Nurse-Midwives regarding their efforts to obtain liability insurance. The American Nurses Association would like to reaffirm that we have explored with ACNM all options to include nurse-midwives under ANA's personal/professional liability insurance policy for registered nurses.

Under the current ANA plan, subscribers are protected for up to $1 million per claim, and $3 million each year in total claims. Because the data indicates that nurses have a very acceptable claims experience, and because there is a large pool of individuals covered by the policy, the cost of the premium is only $45 per year.

Because ANA's policy covers a large number of nurses with a relatively low claims experience, we believe that we have the ability to spread the risk in such a manner that the nurse-midwife population could continue to be subsumed within our covered group. In fact, we believe that incorporation of the nurse-midwives into a larger policy was the optimal strategy with which to address the nurse-midwives' insurance dilemma.

The ANA's plan did cover nurse-midwives practicing under state practice statutes. However, on August 30, ANA's insurance administrator was informed by the underwriter that nurse-midwives would be excluded from coverage.

We were able to negotiate an agreement whereby ANA's policy would extend coverage to nurse-midwives through October 31 of this year and that all existing contracts would be honored to their dates of renewal. Unfortunately, ANA has been unable to negotiate coverage beyond that time.

We believe that this hearing is a valuable first step in addressing this issue. After a sufficient record has been established, we ask this subcommittee to seriously consider the possibility of legislation which will adequately address this problem. We would like to investigate with the subcommittee the possibility of a temporary federally sponsored program of reinsurance with a private carrier of liability insurance for nurse-midwives.

The American Nurses Association would envision a partnership in which insurance coverage would be purchased in the private sector by individual nurse-midwives, with Federal involvement restricted to administration of the reinsurance program.

Furthermore, ANA sees Federal intervention as a temporary measure until liability insurance becomes available from the private market, a measure which would only be extended if the Government determines that there is no change in the availability of reinsurance.

We would like to explore this idea with the subcommittee staff in order to forge a bipartisan solution to the problem. Faced with seemingly insurmountable barriers, we see this as the only viable remedy at this time.

Mr. Chairman, these hearings represent what we hope is the light at the end of the tunnel. We do not come to the Congress because we want to, but because we feel that we must. We ask that you give serious consideration to our request so that the freedom of choice which we all enjoy in this country might continue without barrier to those who choose the services of the certified nurse-midwife

Thank you very much.

[The prepared statement of Ms. Cole follows:]

TESTIMONY

of the

AMERICAN NURSES' ASSOCIATION

Mr. Chairman, I am Eunice Cole, President of the American Nurses' Association (ANA). I am appearing today on behalf of the 185,000 members of our constituent state associations with respect to a crisis situation occurring within the nursing profession: the unavailability of professional liability insurance for certified nurse midwives.

We would like to commend the Chairman and this subcommittee for the timely manner in which these hearings are being held. This reinforces the fact that this subcommittee has always been a strong advocate of the ability of nurses and other practitioners to compete in the marketplace. In its fierce resistance to the proposed professions exemption from the jurisdiction of the Federal Trade Commission, the subcommittee has indicated its support of open and fair competition in the health care industry. Doubtlessly, this action aided in the lessening of price inflation in the industry that has been experienced in the past few years.

We come before the subcommittee today to discuss another major threat to free and open competition in the market. Through the arbitrary and capricious actions of the insurance industry, nurse midwives, who have proven to be cost-effective providers of health care services, may be denied the very opportunity to

practice. Such actions will have the effect of denying access to nurse midwives by consumers who desire their services, and will thwart needed competitive forces in the market for obstetric services. The severity of this crisis is such that we must come before this subcommittee in order to seek relief from a problem that threatens to make obsolete the practice of nurse midwifery.

A certified nurse midwife (CNM) is a nurse educated in the specialty of midw' 'ery. Nurse midwifery practice includes services to normal healthy women and their babies in the areas of prenatal care, labor and delivery management, postpartum care, well-woman gynecology, and normal newborn care. Nurse midwives are graduates of either certificate or masters degree programs in educational programs affiliated with institutions of higher learning accredited by the American College of Nurse Midwives. Nurse midwives work in clinical collaboration with physicians. Nurse midwives must have an alliance agreement and health care protocols with a physician in order to practice. These agreements and protocols establish mechanisms for consultation and referral when complications arise.

Several studies have shown that women who have been served by certified nurse-midwives are satisfied with the safe, effective care they receive. Obstetrical patients from all socio-economic levels who obtain services in a variety of settings have been satisfied with the wide range of family planning and normal pregnancy care provided by CNMs. Patients have expressed preference for the greater ease of communication and the increased possibility of more patient control during delivery with nurse

midwives. In fact, one study found that none of the patients who had been delivered by a CNM would have preferred to have been delivered by an obstetrician. In another study, while patients in a large health maintenance organization expresssed general satisfaction with the care they received from both obstetricians and CNMs, the nurse midwifery patients were significantly more likely to be very satisfied with and very confident in their providers.

Perhaps the major impact that nurse midwives have had on the health care delivery system is the reduction of financial barriers to care. Since they provide care at lower cost than physicians, they have made prenatal, labor and delivery, and postnatal services increasingly available to poor patients. Similarly, CNMs have long been recognized for lowering geographic barriers to care. Nurse midwives often practice in rural and inner city areas where no other alternative exists. There are many instances in which CNMs represent the sole practitioner in a given area. The unavailability of nurse midwifery services in some locations would result in the denial of access to needed obstetrical services to many of our most vulnerable citizens.

Studies have shown that certified nurse midwife care costs are considerably less than physician care. The average salary of a CNM was $24,000 in 1983, while the mean net income of obstetricians in 1983 was $119,900. Other evidence exists that length of stay is shorter for clients of CNMs than for obstetricians, although CNMs tend to care for women with less complications.

It is safe to assume, therefore, that nurse midwives are able to deliver those services for which they are qualified at less cost to the purchaser of those services.

Nurse midwives have proven themselves to be cost-effective providers who have greatly contributed to improved access for underserved populations. At a time when health care expenditures in the U.S. account for over ten percent of the Gross National Product, any provider willing to supply health care at a lower price should be a welcome addition to the market. Nurse midwives offer a lower cost alternative and can aid in alleviating inflationary pressures in the health care industry. The federal government should encourage providers like nurse midwives to market their services in order to increase competitive forces in the industry. The Reagan Administration and the Congress have been effective in recent years in increasing competition in health care; increased use of nurse midwives has and can continue to demonstrate such an effort. The last thing the federal government should want is for providers like nurse midwives to be precluded from offering their services. What the health care market needs is more competition, not less.

Regrettably, a series of events has occurred which threatens the very ability of nurse midwives to continue their practices. Since July 1984, approximately 1,400 CNMs had malpratice insurance coverage under a blanket policy through the American College of Nurse Midwives (ACNM) written by the Mutual Fire, Marine & Inland Insurance Company (Mutual). Unfortunately, the company notified ACNM in May 1985, that their malpractice

insurance policy would not be renewed on July 1, 1985. General conditions in the insurance industry were the basis of the nonrenewal, not the performance of the nurse midwives. In fact, lawsuits have been filed against only six percent of all nurse midwives, as compared with sixty percent of all obstetricians. While there is concern within the insurance industry over the large issue of malpractice coverage of obstetrical care, there is no rational reason to single out the nurse midwives for exclusion from coverage. Nurse midwives, who enjoy a low incidence of malpractice claims, should not have to bear the brunt of concerns surrounding medical malpractice, and neither should those patients who desire the services of a CNM.

In light of this action, the ACNM contacted 17 insurance companies, the bulk of those insurers who underwrite malpractice insurance, seeking coverage. Every company turned down their request. Various appeals to individual insurance companies emphasizing the low risk of nurse midwife practice have been made and rejected. State insurance commissioners and other state officials have also been solicited, but only the state of New Jersey has responded with an offer of insurance from a private carrier.

Several other options exist for CNMs, but are unacceptable for various reasons. In some states, individual nurse midwives have found coverage through an insurer such as a physician-owned company, but such coverage usuall involves practice restrictions, is expensive, and covers only a handful of CNMs. Some state have extended joint underwriting authority (JUA) to include nurse

midwives. However, anticipated premium levels would be too high considering the annual salary of CNMs of $25,000. The same argument applies to the possibility of self-insurance, as the costs, relative to the annual income of a nurse midwife, would he prohibitive. While these options hold the potential for dealing with the crisis of availability of insurance for CNMs, they do not address the equally troublesome problem of affordability of insurance. Nurse midwives and their patients cannot he expected to absorb enormous insurance premiums if the current levels of access and affordability are to he maintained. While we will continue to explore these options, they do not appear to he realistic solutions to the current crisis.

Faced with the aforementioned untenable options, the American Nurses' Associaton decided to explore the option of including nurse midwives under its personal/professional liability insurance policy for all registered nurses. ANA has been providing malpractice liability coverage for nurses since 1951. Under the current ANA Professional/Personal Liability Protection Plan, subscribers are protected for up to $1 million per claim and $3 million each year in total claims. The policy covers all nurses practicing within the scope of the state nurse practice act, regardless of specialty, including nurses in expanded practice such as nurse practitioners and clinical nurse specialists. Because the data indicates that nurses have a very acceptable claims experience and because there is a large pool of individuals covered by the policy, the cost of the premium is only $45 per year By most standards of the insurance industry, this price is low.

In July 1985, the ANA contacted our underwriter regarding coverage of nurse midwives under our policy. As this policy covered a large number of nurses with a relatively low risk experience, we believed that we had the ability to spread the risk in such a manner that the nurse midwife population could be subsumed within our covered group. In fact, we believed that incorporation of the nurse midwives into a larger policy was the optimal way, under the circumstances, to address the access to insurance dilemma. While it might have resulted in somewhat higher premiums for all subscribers, the future of nurse midwifery is important enough to take that risk.

ANA began marketing its coverage to the CNM population, informing them of our scope of coverage and low premium. Our administrator indicated that a substantial number of nurse midwives signed up for coverage under the ANA policy. Just when we thought that a reasonable solution to the problem might exist, our insurance administrator informed us on August 30, that we would be forced to exclude nurse midwives from our policy. While we were able to negotiate an agreement whereby CNMs could sign up until November 1, 1985, and that all existing contracts would be honored for their duration of one year, we could no longer provide liability coverage for the nurse midwives after that date. We were gravely disappointed with the decision that the proposed solution had not proven successful in the long term.

Mr. Chairman, we can only conclude that there is something wrong with an industry in which health care practitioners, who provide cost-effective services and improve access to vulnerable

populations, cannot gain adequate malpractice coverage. It seems particularly unfair when other practitioners, with much higher rates of litigation, have not had their coverage terminated. It becomes even more egregious when an obviously rational option like pooling the risk of nurse midwives with all other nurses is rejected. We are dealing with a system that is fundamentally flawed and in need of serious examination and remedial action.

Mr. Chairman, this crisis will seriously erode consumer choice, is disastrous in terms of competition in the health care industry, and reflects serious problems within the insurance industry. We believe that we have no other choice but to come to Congress with a request for relief. We would not make this request if this was not an alarming problem, for which all possible options have been explored and rejected. Moreover, this is a national problem, as the country is faced with the potential of losing a well respected, necessary provider of health care.

We believe this hearing is a valuable first step in addressing this issue. After a sufficient record has been established, we ask that this subcommittee seriously consider the possibility of legislation which will adequately address this problem. We would like to investigate with the subcommittee the possibility of a temporary, federally sponsored program of reinsurance with a private carrier of liability insurance for nurse midwives. In addition, the federal government would act as guarantor for excess insurance coverage.

This would involve a partnership in which the first level of insurance coverage would be purchased by individual nurse midwives with federal involvement only when necessary. Moreover, this is only a temporary measure until liability insurance becomes available from the private market, and would only be extended if the government determines that there is no change in availability of reinsurance from the private sector. We would like to further refine this idea with the subcommittee staff in order to forge a bipartisan solution to the problem. Regrettably, at this point, we see this as the only viable remedy to this unfortunate predicament.

Mr. Chairman, these hearings represent what we hope is the beginning of the end of this tragic situation. We do not come to the Congress because we want to, but because we must. We ask that you give serious consideration to our request, so that women continue to have the freedom to choose the provider of their choice. Without Congressional action, we fear such a choice will no longer exist.

Mr. FLORIO. Thank you very much. Mr. Pressman.

STATEMENT OF HYMAN A. PRESSMAN

Mr. PRESSMAN. Mr. Chairman and members of the committee, I am Hyman Pressman, city comptroller of the city of Baltimore.

When I was first elected city comptroller of Baltimore City in 1963, I removed politics from the purchase of insurance and initiated competitive bidding, thereby saving as much as 40 percent on our premiums.

Now we have run into a problem which is not our own doing but the fault of the insurance industry.

Baltimore City's master property insurance, which cost $315,000 in 1984, has been raised to cost $1,700,000 in 1985. In addition, we have been unable to get any company to write fidelity bonding for our employees.

Another Maryland city, Sykesville, has been unable to obtain liability insurance. Various officials in Sykesville have resigned rather than to take a chance on being held personally liable because of the failure to obtain insurance.

In many instances, insurance companies have refused to provide any type of insurance for a municipality. There are already too many factors which discourage competent people from running for public office. The danger of being held personally responsible because of the failure to obtain insurance could further discourage potential office holders, thereby undermining the chances of getting good government.

As has been pointed out, insurance companies collect premiums and invest. Thus, they depend on investment income to help pay for losses. In recent years, inflation and high returns on investments enticed insurance companies to disregard sound underwriting principles in order to cash in on investment opportunity. They concentrated more and more on getting more business so they could invest the premiums, and less and less on prudent practices.

Stated more succinctly, they gambled and lost, and now they want the public to pay for their imprudence by paying higher premiums. They want to make up 1984 losses in a great big hurry.

We have a chart here that we would like the committee to look at. It is just remarkable what a good record we have had on this same policy that they increased from $315,000 to $1,700,000.

In the 18 years before 1985, which are the years that are now available, premiums paid to insurance companies totaled $6,309,640. Claims paid by insurance companies, believe it or not, the grand total was $506,000, and yet they dare raise our premium from $315,000 to $1,700,000.

Now, under this record, the insurance company that insured the city on this property insurance made a profit of $5,803,640, plus investment income on the full $6,309,640. Yet, they dare to increase our insurance premium from $315,000 to $1,700,000.

The insurance companies made this huge profit and then they turn around and increase our premium to the great extent that they did.

Now, we had a big fire in 1985. The claim hasn't been settled, but we estimate that the claim settlement will be about $3,300,000.

Apparently, the insurance company wishes to disregard the 18-year record of negligible losses and to concentrate on the 1985 fire.

It seems to me that this record points up the need for a congressional investigation which could lead to the establishment of a Federal regulatory agency to regulate the insurance industry. The insurance industry is abusing the public and getting away with it.

The duty of Congress is clear. The Congress that enacted the antitrust acts, the civil rights acts, the community service acts, the Truth in Lending Act and the Consumer Protection Act should come to the aid of municipalities, States, nursing homes, hospitals, and anyone else who is being abused by insurance companies.

Mr. FLORIO. Thank you very much.

Mr. Kopke.

STATEMENT OF RICHARD KOPKE

Mr. KOPKE. My name is Richard Kopke. I am currently representing the New York State Housing Authorities as chairman of the New York State Association of Renewal and Housing Officials [NYSARHO] Insurance Committee. I am also the executive director of an Upstate New York Housing Authority.

The committee has been charged in New York State with reviewing the alternative possibilities for liability insurancing resulting from the scarcity of policies offered currently to housing authorities.

We have looked into primary coverage with carriers and paying their high premiums. We have looked into large deductibles with excess insurance, acting as our own agents, in essence, for the primary coverage; self-funded programs, a pooling program; self-insurance; and any combination of the above.

The Housing Authorities in past years, namely, our own, which I use as an example, was paying 2 to 5 percent of our operating income for all insurances, all premiums for insurances. This year we are faced with paying 20 to 25 percent of our operating income for insurance premiums.

In our town that represents an increase to our already astounding operating deficit of $584,000. We are a relatively small housing authority, that being 1,700 apartments. The deficit now has jumped to $824,000. This obviously will result in deep cuts in our services being offered to our tenants.

The only manner we have to generate income is through rents, which are fixed at 30 percent of a tenant's income, fixed by the Department of Housing and Urban Development; interest earned on our investments; and our Federal operating subsidy, which is established by a fixed formula, again by HUD.

This formula has resulted in a decreasing subsidy over the past 10 years to housing authorities in general.

The problem of fixed income, limited ability to decrease our operating expenses, and the decrease in Federal subsidies leaves us in quite a bind, needless to say, at the housing authority level in New York State, which I am sure is similar throughout the country.

I bring as an example a situation that our housing authority has gone through in our own attempts to obtain insurance. In 1982 through 1985, our loss ratio was artificially inflated due to the un-

characteristically low premium rate that was offered by our last carrier. That premium rate was about $8.50 per apartment per year. The low rate was the result of a desire by the carriers to obtain funds to invest at the time of the high interest market.

In addition, the amount of funds reserved for future settlements for outstanding claims was nearly 10 times the dollar amount that has actually been paid for claims that are closed.

The premium rate for our housing authority for 1978 to 1981 for comprehensive general liability was approximately $22. That was the prior 3 years to our past 3 years. The loss ratio experienced in 1982 to 1985 by the current carrier is approximately 293 percent. For every dollar in premiums, they lost almost $3 in losses.

Using the 1978 and 1981 figures, however, of $22 per unit, there would have been nearly no loss whatsoever. Thus it appears that the insurance company's decision to offer a reduced premium rate was a miscalculation and the housing authorities are now paying for that particular decision.

The reaction by the housing authorities must be to cut our expenses anywhere we can. The alternatives are our staff and community services.

Services that we are looking reluctantly at reducing are: no longer permitting public housing authority space to be used by community functions such as Boy Scouts, Girl Scouts, Cooperative Extension and Education Programs; eliminating day care services; eliminating Federal Commodities Distribution Program, which brings a lot of folks to our sites; eliminating the sponsorship and space for meal sites for senior citizens and nutrition programs; eliminating the use of public housing authority playgrounds by its tenants; reducing construction and rehabilitation activities to a bare minimum; and we are considering strongly only accepting new tenants on an emergency basis in order to reduce the number of people that have an opportunity for a liability claim on our property.

In summary, the reducing of services must be avoided if at all possible. The prime objective of public housing authorities is to serve the needs of low and moderate income families and senior citizens.

The organization I represent and the housing authorities in New York State stand ready to assist the subcommittee in any way we can to help in solving this problem.

Thank you.

[Testimony resumes on p. 177.]

[The prepared statement of Mr. Kopke with attachments follows:]

NYSARHO, inc.

NEW YORK STATE ASSOCIATION OF RENEWAL & HOUSING OFFICIALS, INC

STATE OFFICE • 100 STATE STREET • ALBANY N Y 12207 • (518) 463-

September 18, 1985

U.S. House of Representatives
Committee on Energy & Commerce
Subcommittee on Commerce, Tranportation
& Tourism
Mr. James J. Florio, Chairman
Rayburn House Office Building
Washington, D.C. 20515

Dear Committee Members:

As Chairman of the Ad Hoc Insurance Committee for the New York State Association of Renewal & Housing Officials, Inc., I would like to thank the Subcommittee for offering me the opportunity to express the concerns of Public Housing Authorities as to the scarcity and high premium costs for Comprehensive General Liability.

The Annual Contributions Contract entered into between HUD and all federally subsidized Public Housing Authorities (PHA's), requires that PHA's obtain Comprehensive General Liability (CGL) insurance for it's properties. Until 1985, this requirement was not difficult for us to comply with and represented anywhere from a low of 2 to 3%, to a high of 4 to 5% of our rental income before subsidy for all insurance for our PHA's. However, the most recent premium quotes received by NYSARHO through an open-competitive bid, reflect a 1500% increase in CGL insurance rates and, therefore, would significantly alter our operating budgets for insurance premiums of from 20-25% of rental income before subsidy.

For the Schenectady Housing Authority, the unanticipated increase in premiums of $240,000, increased an already high operating deficit of $584,000 to $824,000. As a not-for-profit municipal corporation, the PHA's operate under strict State and Federal regulations.

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The only manner we have of generating income is the rents and the investment of those rents on a short-term basis. The rental rates are pre-determined and controlled by the Federal Department of HUD (for Federal Housing Projects) and PHA's are not permitted to adjust or modify the HUD-determined rental which is basically 30% of an applicants family income.

The only other source of income which is able to offset operating expenses, is the federal operating subsidy which is determined by a fixed HUD formula based on a summary of budget data and justifications for expenses. The subsidy formula, over the years, has been subject to various modifications by each administration and resulted in proportionally less subsidy as compared to rental income.

The hard facts of fixed rental income, limited return on investments, and dwindling federal subsidies, do not leave Public Housing Authorities much alternatives as to how to reduce operating losses other than by cutting services to the very clients we are attempting to assist; the low and moderate income families and elderly citizens.

The NYSARHO Insurance Committee has made an earnest attempt to obtain CGL at a reasonable rate for PHA's in New York State but with little success, unfortunately. It appears that a variety of reasons abound for the lack of interest in writing insurance for PHA's:

1. High loss ratio
2. Bid business unattractive
3. Risk factor of municipal businesses
4. Increasing awards (by juries) for damages

The above arguments have been investigated and reviewed by the NYSARHO Insurance Committee and the following response is offered:

1. The high loss ratio reflected by the risk experience summary for the period August 1, 1982 through August 1, 1985, is artificially inflated due to the uncharacteristically low premium rate (average of $8.65 per housing unit) offered by the last carrier. The low rate was a result of the desire of the carriers to obtain funds quickly for investment purposes in a high interest market. Low premium rates would be offset by high interest earned on investments. In addition, the amount of funds reserved for future settlement of outstanding claims is nearly 10 times the dollar amount that has actually been paid to claimant on closed cases.

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The premium rates for the Schenectady Housing Authority for March 1, 1978 to March 1, 1981 for CGL insurance was approximately $21.50 per unit per year. The loss ratio experienced by the 82/85 CGL carrier for the PHA's active (approximately 60) in this NYSARHO group insurance program was 293%. This means that for each $1.00 in premiums, the carrier anticipates losing $2.93 if all current claims were settled for the amount the carrier reserved. Using the carrier's figures of $3,464,558 in losses for a coverage period of August 1, 1982 to August 1, 1985, at an earned premium of $1,179,252 (thus the 293% loss), it would compute that an average of $8.36 per unit was charged by the carrier. If the 1978/81 rate of $21.45 had been used, the earned premium would have been $3,166,771. It appears that the insurance companies' decision to offer a reduced premium rate in 1982/85 was a miscalculation that the PHA's are paying for now many times over.

2. The Federal and State regulation require that PHA's competitively bid for their insurance needs. Unless the government regulations are changed, there is little individual PHA's can do about the bidding requirements except insure the bids are prepared with a thorough understanding of the current and projected insurance market.

3. Good business practices obviously encourage a profit-making entity to invest its efforts and assets in a venture that will have the greatest return for its investment. There appears to be an ample number of less risky businesses in the market looking for insurance that insurance companies prefer to write at the expense of PHA's. Current legislation does not require, as it does for automobile insurance, that insurance companies must write a certain amount for more "risky" clients. Until there is an incentive, be it either financial or legislative, for carriers to become reinvolved in municipal business, it will remain expensive or impossible for PHA's to secure Comprehensive General Liability Insurance.

4. A brief review of the damages being awarded on liability claims by juries would justify an insurance companies reluctance to write municipal business. There have been proposals by both the insurance industry and municipal organizations to establish legislation for limits or a "cap" of $150,000 per claimant and $450,000 per occurrence to reduce the maximum exposure of public entities. These "caps" would understandably vary from state to state and would not apply to wrongful death and intentional torts.

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Further, in the Court of Claims Act of 1929, a Special Court was established to hear claims against the state government in non-jury trials. It has been noted that judges tend to award more moderate damages than juries and, perhaps legislation could aid in permitting this judicial process to be offered at the municipal level of government.

The above comments are offered as observations only and have not been reviewed indepth by the NYSARHO Insurance Committee at this time.

In Summary, Public Housing Authorities, with their limited power to control either operating income and many of their operating expenses which are also controlled to a great degree by Federal and State regulations, have few options in reacting to rising operating expenses. Authorities will be forced to make cuts in the area of tenants services and staffing in order to reduce expenses which will certainly effect the quality of living for our tenants. In order that the exposure to future liability claims be reduced, we must limit or eliminate many services now offered at no charge or minimal cost to tenants, such as:

- elimination of community activities such as boy scout and girl scout meetings on PHA properties
- elimination of day care programs offed to tenants and neighborhood families
- eliminate participation in the Federal Commodities Distribution Program that bring large numbers of individuals to PHA sites
- no longer offer a mealsite location for Senior Citizen Nutrition Programs
- eliminate use of playground facilities by tenants
- reduce construction and rehabilitation activities
- strongly consider restricting new applications for housing to emergencies only to reduce the number of tenants, thus reducing the liability exposure

The above mentioned actions are not attractive options but must be considered if PHA's are forced to be self-insured. The exposure to potential liability losses must be carefully considered if we are unable to obtain Comprehensive General Liability insurance at a reasonable rate. The elimination or reduction in tenant services and community activities is in direct conflict with the very purpose of public housing and should be avoided, if at all possible. It is one of the primary objectives for those of us in the housing field to offer a decent, safe and sanitary environment in which to live for low and moderate income families and senior citizens.

The Member Housing Authorities of the New York State Association of Renewal and Housing Officials stand ready and willing to assist the Subcommittee on Commerce, Transportation and Tourism in their investigation into the problems of obtaining insurance at reasonable rates for Public Housing Authorities.

Very truly yours,

Richard R. Kopke

Richard R. Kopke, Chairman
Ad Hoc Insurance Committee,
NYSARHO
Executive Director,
Schenectady Housing Authority

U.S. House of Representatives

Committee on Energy and Commerce

SUBCOMMITTEE ON COMMERCE TRANSPORTATION AND TOURISM

Washington, DC 20515

ROOM H2-1[illegible]
HOUSE OFFICE BUILDING ANNEX NO. 2
PHONE 202 226 3160

GREGOR[illegible] E. LAW[illegible]
CHIEF COUNSEL AND STAFF DIRECTOR

September 11, 1985

Mr. Richard Kopke
Chairman
Ad hoc Insurance Committee
New York State Association of Renewal
& Housing Officials, Inc.
375 Broadway
Schenectady, New York 12305

Dear Mr. Kopke:

The Subcommittee on Commerce, Transportation and Tourism will hold a hearing on Thursday, September 19, 1985 to examine the problems purchasers of insurance are experiencing because of the overall scarcity and high cost of property-casualty liability coverage. The hearing will commence at 9:30 a.m. in the Rayburn House Office Building in a room to be announced.

This letter is to request that you appear at the hearing to testify regarding the problems that state housing authorities are having in obtaining adequate and affordable liability coverage. The Subcommittee would also like a summary of your view's as to how the scarcity and high cost of liability coverage is affecting the ability to housing authorities to provide services.

In accordance with Subcommittee rules, please deliver 75 copies of your testimony to the full Committee offices, Room 2125 of the Rayburn House Office Building, no later than 24 hours in advance of the hearing. In addition, please deliver 18 copies of your statement to the Subcommittee offices, Room H2-151, House Office Building Annex 2, 3rd and D Streets, S.W., Washington, D.C. 20515, no later than noon on Wednesday, September 18, 1985. While your written statement may be whatever length you consider appropriate, we ask that you limit your oral statement to five minutes.

On behalf of the Subcommittee, I extend our appreciation for your cooperation and look forward to hearing your views.

Sincerely,

James J. Florio, Chairman
Subcommittee on
Commerce, Transportation and Tourism

NYSARHO, inc.

NEW YORK STATE ASSOCIATION OF RENEWAL & HOUSING OFFICIALS, INC

STATE OFFICE • 100 STATE STREET • ALBANY N Y 12207 • (518) 463-31[illegible]

TO: OUR SENATORS AND CONGRESSPEOPLE

RE: LIABILITY INSURANCE FOR HOUSING AUTHORITIES

We face a crisis in the State relative to problems caused by an increase in liability insurance from $7.56 per dwelling unit three years ago to $123.00 per dwelling unit this year. We obtained an extension from the $7.56 carrier to September 23, 1985 and some smaller authorities have been able to find coverage within the $40 - $50 range, but the larger authorities are preparing to dip into their reserves to pay this unbudgeted and unplanned-for increase.

These tremendous increases by the insurance industry are being felt across the board; i.e., municipalities, school districts, transportation authorities, etc., - almost all public and quasi-public bodies are now being made aware of it.

We don't pretend to understand it, nor are we prone to accept the industry's explanations of why 1500% increases are necessary this year. We are, however, prone to suggest that the Congress could find out why these increases are coming into force so suddenly and not over a term of years. Nothing in our knowledge has moved so precipitiously. And we can't believe that the think tanks of the multi-billion dollar insurance industry were caught so short that they have to recover in one single bound.

We are troubled and will appreciate your advice.

Very truly yours,

F. Joseph Leone,
Executive Director

FJL:n

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SCH'DY, N. Y.

c: J. Donald Leahey, President, NYSARHO

DATE: August 28, 1985

Affiliated with the N Y Conference of Mayors and Municipal Officials, National Association of Housing and Redevelopment Officials Middle Atlantic Regional Council (NAHRO), and National Housing Conference Inc

NYSAHRO INC SEPTEMBER, 1986

Insurance Woes Hit Public Housing

By Philip Hurkin

Troy City Record

TROY — Public housing authorities, along with everyone else these days, are facing a crisis in skyrocketing liability insurance premiums.

Facing increases of more than 1,000 percent in the state this year, they are in a particularly precarious position. Most housing budgets hold no closets full of extra funds to draw from; there is no seat at the table for this new mouth to feed.

The problem is especially enigmatic for municipal housing authorities because revenues are fixed. Rents are set by federal law at 30 percent of tenants' incomes, and subsidies are set by the federal Department of Housing and Urban Development.

"We don't net profits, we operate at a loss," said Richard Kapke, executive director of the Schenectady Housing Authority.

Three years ago, one three year package was offered to bid for all housing authorities in the state, put together by the state Association of Renewal and Housing Officials according to state and federal specifications.

The bid was taken by the Jardine Ter Bush and Powell insurance group at a base rate of about $8 per unit of housing, statewide, according to Joseph Leone, executive director of the association.

"That was nice. However they caught up with us this year," he said. Only one group, William H. Connolly and Co. of Montclair, New Jersey, bid for the contract this year, at a price of $120 per unit.

"That was phenomenal," Leone said. "So we threw that out and asked them to submit proposals for individual authorities," based on loss information provided by the previous insurer. That resulted in proposals that ranged from $87.50 to $123 per unit. The policies are scheduled to go into effect Wednesday, if the premiums are paid by then.

"When the (bid) price was read, we all just about fainted," said Donald Leahey, executive director of the Rensselaer Housing Authority and a member of the association insurance committee. Although his agency is not insured under the Jardine plan and, uniquely, will not need a new policy this year, he said authorities will not be able to meet the increased costs without increased subsidies from HUD.

"I don't see any way in the world we can, we just can't," he said. "Our rents are based on income (and cannot be raised). Let's face it, they've got us. We're just the little guys that are gonna get hit."

"They've got us. We're not big enough to self-insure," said Charles Patricelli, executive director of the Watervliet Housing Authority, facing an increase from $14 to $123 for each of its 381 units, totaling $47,000.

"We're just going to have to pay for it. We'll have to get the money from someplace. It would have to come from our capital reserve account ... or services may have to be cut, probably in regular improvements or ongoing maintenance."

"It would have to come out of the pie someplace," said Warren Brown of the Troy Housing Authority, and would probably come out of staff and service costs, "unless HUD allowed it to come out of reserves. But you can't take $200,000 out of your reserves every year." With the Connolly bid, Troy is facing an increase from $9 to about $100 per unit for 2,000 apartments, from about $18,000 to $200,000.

Insurance Woes Hit Public Housing

(Continued from Page 1)

The Schenectady Housing Authority managed to get an offer from Alexander and Alexander, a Texas firm that all of the others have contacted, for coverage at $35 a unit. Connolly had quoted $123 per unit, but the lower offer still represents a huge increase from the $7.50 Schenectady paid before.

Richard Kapke, the authority's executive director, said the extra funds will have to come from the reserve account, which is used to make up the difference between operating expenses of about $220 for each apartment annually and $190 of revenue from rents and subsidies. The reserve will be depleted that much more rapidly if it is used for insurance premiums.

"And when that's gone, we're out of business." The other alternatives would be to cut staff and services or cut utilities, neither of which are realistic, he said.

Leone said his group has urged all authorities to "make a few phone calls" to try to drum up a better rate. HUD has given permission for authorities to shop around for a better price without even going to bid, telling them to go for whatever they can get.

But so far few companies seem to be interested in picking up the contracts at any price.

"They won't even talk to you," Brown said. "We have advertised for bids locally but we've had no interest." With nationwide inquiries it has been the same story. "We don't have a quote," he said.

"(Connolly) is the only one that's been interested so far," said Patricelli. All the others he has contacted "don't seem to be even the least bit interested in us."

Other authorities reported the same difficulty, the inability to get insurance companies to even make an offer, let alone a better offer.

"They don't want the business," Leone said. "(Connolly said) our loss experience justified the higher quote. (The Jardine group, which did not submit a bid) could probably make a case for losing money on it, yeah. But that's the insurance business, and we're not experts in that. All we're expert in is fulfilling the specifications set by HUD."

"We've got 5,800 people running around; there's no question that somebody's going to get hurt," said Joseph Laden, executive director of the Albany Housing Authority.

"There's some justification for an increase but not for a 1,000 percent increase," Laden said. Albany, with almost 2,400 apartments, is facing an increase from about $8 to $120 per unit, a total increase of more than $200,000.

He said the number of claims paid is not the cause of the increases, it is the size of the awards coming out of the courts. The blame for that rests either on the courts for being too lenient or the attorneys for being too aggressive, he said, but that is a moot point.

Patricelli said the problem is that the insurance companies are making judgment based on claims filed and not on the number or amount of claims paid.

"The problem is that there are so many of these silly claims (claims that are never paid) ... we seem to be a target. But regardless of whether it's paid, it hurts."

It looks as though HUD is not going to be able to help anyone meet the increased costs soon, but it is telling all they must have liability insurance.

Harry Rosen, chief assistant housing manager for HUD in Buffalo, said his agency is pursuing several possibilities, one of which would result in increased subsidies.

"We're going to attempt to mitigate the impact as much as possible on any housing authorities," he said. "We're getting the information from the individual authorities on how (the increases) affect their budgets, information which will then be passed on to Washington for consideration."

Other possibilities under consideration include consolidation of groups of authorities under one coverage that could save money, and implementation of self insurance programs for groups that are large enough to handle it. Most of the groups in the state are too small for that, however, he said, and HUD is not encouraging it.

One other possibility is that HUD would implement a nationwide insurance program for all of the 3,300 housing authorities in the country except for the largest ones. HUD may shy from such an undertaking, but as Kapke said, "If each one kicked in $50,000 or $60,000, that's a lot of millions."

The Cohoes Housing Authority, for one, will not feel the crunch as badly as others this year due to the foresight of Executive Director Marsha A. Surprenant, who planned for the increase.

"I put $50,000 (in the budget) for it for next year. My accountant thought I was crazy," she said. The premium for the 310 units in Cohoes shot up from about $4,500 to $30,000. But she said HUD is going to have to do something to either alleviate the situation or help authorities make up the difference.

"I think they are going to almost have to. We all are having the same problem."

MINUTES:	From Ad Hock Insurance Committee (NYSARHO)	
DATE:	September 10, 1985	
TIME:	11:00 a.m.	
PLACE:	Schenectady Municipal Housing Authority	
COMMITTEE MEMBERS:	Richard Kopke, Chairman, SMHA	(Present)
	Marian Cauley, Assigned Director	(Absent)
	Sal Convertino, Assigned Officer (UHA)	(Present)
	Myron Bender (DHCR)	(Absent)
	Joseph Laden (AHA)	(Absent)
	Donald Leahy, President (NYSARHO)	(Present)
	Charles Patricelli (WHA)	(Present)
	Martha Surprenant (CHA)	(Present)
	Ralph Leckey (HUD Central Office)	(Absent)
	Robert Dickerson (BHA)	(Present)
	Michael Parente (SMHA)	(Present)
	Rose Polsinelli (SMHA)	(Present)
	Lenore Fox (SMHA)	(Present)
	Warren Brown (THA)	(Present)
	John Lake, Sr. (BHA)	(Present)

The meeting came to order at approximately 11:30 a.m. and the following agenda was set:

1. Review minutes of August 27, 1985.
2. Comments from Conference of Mayors.
3. Comments by Ralph Leckey, HUD Central Office.
4. Corroon and Black Proposal.
5. Jardine Proposal.
6. Suggestions from the Committee.

A summary of the topics covered is as follows:

1. Minutes were adopted as presented and it was suggested by the Committee that copies of the minutes and correspondence be forwarded to the following people:
   Joseph Lynch, Manager, Buffalo Area Office of HUD
   Joseph Monticello, Director, Regional Office of HUD
   Joseph Porter, Conference of Mayors
   Senator D'Amato
   Senator Moynihan
   Nat Parish, Legislative Committee Chairman
   Joseph Leone, Executive Director, NYSARHO

2. Comments from Conference of Mayors.

   The Committee Chairman contacted Mr. Joe Porter with the Conference of Mayors, 119 Washington Avenue, Albany, New York 12210, Telephone number 463-1185. Mr. Porter indicated that the Conference of Mayors were pushing hard for State Legislation and that Assembly Cramer has a bill pending in the Senate which has already passed the Assembly, which would place controls on liability claims within the State of New York and also govern the activities regarding insurance pools . New York State.

Mr. Porter was not sure if public housing authorities currently have state authority to utilize insurance "pooling". The Conference of Mayors is currently working on legislation to limit the settlements with respect to liability claims and tort suits against municipalities. They would like to see a $150,000 limit on individual and $450,000 per currents limit placed awards for liability claims. They would also like to see objective standards established for payment suffering injuries by which awards could be established.

Mr. Porter was not aware previous to our conversation that municipal housing authorities were being subjected to similar insurance premium rates for Comprehensive General Liability as municipalities had been subject to. He requested that the Insurance Committee forward to him a history of the problem along with minutes from our meetings. This will be done.

3. Comments by Ralph Leckey, HUD Central, Washington, D.C.

On September 10th, Richard Kopke had a telephone conversation with Ralph Leckey, who indicated no new proposals have been forthcoming as far as he knew. HUD had, however, been approving insurance carriers on an individual basis as a PHA contacted them. Several housing authorities had contacted HUD requesting a waiver from their ACC with respect to comprehensive liability which has been approved by HUD. However, those housing authorities that are requesting self-insuring themselves were rejected by HUD. Mr. Leckey went on to say that HUD would be reviewing on PHA by PHA basis, each proposal for insurance and the premiums being paid for that insurance. HUD would determine if the premiums would be excessive, taking into consideration the housing authorities reserve status at the time. In other words, if the housing authority had sufficient reserves, HUD would not consider additional subsidy to cover excessively high premiums. However, if the housing authority was "troubled" then HUD would consider additional subsidy to cover the unanticipated expense.

The above statement concerned of those members of the committee inasmuch as it appears that HUD was willing to allow premiun rates to effectively reduce reserve levels to a point where housing authorities could then be detemined to be financially troubled by HUD. Several of the Committee Members felt that they were being penalized for developing healthy reserves over the past few years, now only to see those reserves dwindle as a result of run-away insurance premium fees.

Mr. Leckey whent on to explain that State Insurance Commissioners established a premium written to dollar surplus ratio in order that insurance companies within their states remain solvent and secure. He stated that a comfortable ratio would be $3.00 of premiums written to $1.00 in surplus. An extended company would have a ratio of $5.00 or $6.00 of premiums written to $1.00 in surplus.

He also suggested that the housing a thority obtain releases on all settled insurance claims, espe ally for minors. However, even if a parent signs off for a minor, the minor still has the right to litigate the matter until his her 21st birthday.

In a conversation with Tom O'Callahan, Ric ard Kopke found no new information regarding insurance proposals received by the HUD Regional Office in New York.

4. Corroon and Black Proposal.

The Chairman of the Insurance Committee is awaiting a proposal from Corroon and Black which will include a deductible with an appropriate reduction in premium rate. As soon as this is received, it will be distributed to other Members of the Committee and to NYSARHO.

5. Jardine Proposal.

A similar insurance proposal is being prepared by Jardine as that of Corroon and Black.

6. Suggestions by Committee Members.

   a. Bob Dickerson of Buffalo Housing Authority suggested that Lords of London be contacted directly.

   b. Sal Convertino of Utica Housing Authority suggested that the Committee Connolly Insurance Company directly to meet with them regarding the possibility of a deductible and a resulting reduction in premiums. After the meeting, Connolly was contacted and a meeting was set for 11:00 a.m., 9/12/85 with John Hughes in the Montclair New Jersey Office. (See minutes of that meeting for urther details).

The Committee meeting adjourned at 12:40 p.m.

MINUTES:	From Ad Hoc Committee Meeting with John Hughes of William H. Connolly & Company
DATE:	September 12, 1985
TIME:	11:00 a.m.
PLACE:	William H. Connolly & Company Offices 14 South Park Street, Montclair, New Jersey

COMMITTEE MEMBERS:	Richard Kopke, (SMHA)	(Present)
	John Lake, Sr. (BHA)	(Present)
	Warren Brown, (THA)	(Present)
	Robert Dickerson, (BHA)	(Present)
	John Hughes, Connolly & Company	(Present)

John Hughes of Connolly and Company was asked how the rates were determined by Great Global, the Insurance Carrier being represented. Mr. Hughes indicated that the experience rate was not the sole reason for high premiums, and in fact, was not the primary reason for the high premiums. The major reason was the high cost of re-insurance and that very few markets were available. The reason that Connolly and Company did not quote a deductible was that the original bid package they had bid on, only requested full coverage. He had, however, quoted to Syracuse Housing Authority, a deductible of approximately $50,000 which only reflected a 10% reduction in premium and obviously was not attractive to the PHA. He then gave a brief review of Great Global as an Insurance Company indicating that it had recently changed hands and as a result, Best deferred their rating. He further went on to inform us that Great Global does retain their losses, but in fact, sells them to Insbrook Ins. Co., the General Agent and Connolly would then deal with them, rather than with Great Global.

When asked about the letter he wrote to several housing authorities, indicating that the Great Global policies were dated August 31st and their offer would not be available to housing authorities past that date, Mr. Hughes explained that this was a requirement placed on Great Global in their home state of Arizona. Apparently the Arizona Insurance Commissioner felt that Great Global had exceeded a comfortable ratio of premiums written to dollars and surplus and was requiring Great Global to cease writing new policies as of August 31st. Therefore, Connolly & Company forwarded policies to all housing authorities in the NYSARHO Group Program in order that August 31st deadline could be met.

Those PHA's that turned down the Connolly & Company proposal now no longer have the option of signing with Great Global, for they can no longer write new coverage. Those PHA's holding unsigned policies, ~~however~~, still have the option to sign with Great Global, however, they must use the original premium prices and the date of August 31st.

When asked why the rates were so high, Mr. Hughes indicated that the manual rate from a premium code book reflects that private housing is double that of the rate being offered by Great Global

for PHA housing sites.

To date, of the 51 housing authorities quoted prices by Connolly and Company, Mr. Hughes has found that 14 have been covered at a lower premium by other carriers and 8 have paid their premiums to Connolly and Company. Therefore, a majority of housing authorities contacted by Connolly and Company remain in the market for Comprehensive General Liability. Several Committee Members questioned Mr. Hughes as to the mechanism that would be followed if the housing authorities had a $25,000 deductible and a primary coverage insurance program. The following would take place:

1. Claim would be made by a tenant to the housing authority.
2. The housing authority would forward a claim to Connolly and Company.
3. They would investigate the claim.
4. A reserve would be established for the claim if it was found to be covered by the policy.
5. A settlement, if appropriate, would be offered the claimant without the PHA's approval or review.
6. If the settlement was an excessive $25,000, the company would pick up the excess portion and the PHA would pay a minimum of $25,000.
7. If the settlement was under $25,000, the PHAwould pay the entire settlement. A caution with this system would be that the settlement could be made by the insurance company without the PHA's input, thus allowing for small settlements at the housing authorities expense.

Mr. Hughes was then questioned with respect to an excess policy which would include only catastrophic coverage with all primary coverage being provided by the PHA directly

1. Could protect the housing authorities interest better than a primary policy with a deductible.
2. No settlements would be made without the PHA's direct input.
3. No reserves would be established without the PHA's direct input.
4. A problem with this type policy would be, it would take nearly six months at a minimum to set up such a program.

When asked about pooling, Mr. Hughes comments were:

1. Could take a very long time to establish.
2. Bylaws must be worked out in detail prior to start-up the program
3. Connolly is able to coordinate and operate pools, however, they are not sure New York State laws with respect to the availability of pooling to public housing authorities.

The Committee asked Mr. Hughes whether or not it would be beneficial to housing authorities to separately insure for liability, various projects, project by project. He indicated that Comprehensive General Liability is just that, comprehensive for all public housing authority properties, not by specific site. Therefore, a PHA cannot break-out certain "high risk" properties. If an accident occurred on any property owned by the public housing authority under a Comprehensive General Liability Policy, the carrier of that policy would have to respond to the claim.

If two policies have been written, one on one site; one on another site, Mr. Hughes indicated that would merely mean that claimant could go after two companies rather than one.

In conclusion, it appears that the problem can be summarized by stating that insurance companies are writing sufficient business with more secure businesses and they really don't need to write insurance policies for the more risky businesses like public housing authorities. If an insurance company has the capability of writing $5,000,000 worth of insurance, it does not make good business sense to choose a high-risk client over a more secure client. Municipalities, municipal housing authorities, school bus companies, physicians, etc., are all considered to be high-risk clients and as a result, we find ourselves in a difficult position of obtaining General Comprehensive liability insurance in a less than favorable market.

Meeting concluded at approximately 1:15 p.m.

MINUTES:	From Ad Hoc Insurance Committee (NYSARHO)
DATE:	August 27, 1985
TIME:	11:00 a.m.
PLACE:	Albany Housing Authority, Albany, New York

COMMITTEE MEMBERS:	Richard Kopke, Chairman	(Present)
	Marian Cauley, Assigned Director	Absent ([redacted])
	Sal Convertino, Assigned Officer	(Present)
	Myron Bender (DHCR)	(Absent)
	Joseph Laden	(Present)
	J. Donald Leahy, President, NYSARHO	(Present)
	Charles Patricelli	(Present)
	Martha Surprenant	(Present)
	Ralph Leckey, HUD Central Office	(Absent)

The meeting came to order approximately 11:00 a.m. and the following agenda was set:

1. Review of minutes of meeting held on August 19, 1985.
2. Review of proposal received by Tom O'Callahan, HUD, New York City Regional Office
3. Review of loss experience for New York State Housing Authorities participating in the NYSARHO Insurance Blanket Program - 8182 through 8184.
4. Review of Surplus Marketing Services Self Funded Insurance Program.
5. Various options available to Housing Authorities with respect to Comprehensive General Liability.
6. Directors and Officers liability coverage.
7. Adjournment.

A summary of the topics covered is as follows.

1. Minutes were adopted as presented.
2. Group coverage for Comprehensive General Liability has not been received by Tom O'Callahan of the New York City Regional HUD Office, therefore, has not been transmitted to the NYSARHO Insurance Committee as of the date of this meeting. Joe Laden, Executive Director, Albany Housing Authority, in a telephone conversation with Mr. O'Callahan indicated that the New York City Housing Authority would be the base housing authority for a proposal from Corroon and Black which was to be received by Mr. O'Callahan no later than 8/31/85. Mr. Laden distributed a questionaire that was to be filled out by each housing authority giving more specific information about each housing authority. (See attached labeled agenda item #2).

3. The Committee received copies of the Risk Experience Report as prepared by Zurich-American Insurance Companies. The report reflected the loss experience over a period from 8/1/82 to 8/1/84 showing an overall current premium of $1,179,252, total number of claims 474, amount paid on claims $517,279, amount of expenses $134,220, amount of open reserve $2,812,958, total of $3,464,558 with a loss ratio of 293%.

   The open reserve amount represents the amount of money that the insurance company has set aside on open claims. Seldom do the claims consume the full reserve amount set aside, so housing authorities can expect to see a loss ratio of less than 293% once all claims are settled.

   It must be kept in mind that this loss ratio of 293% is based on a premium rate of approximately $7 50 per unit, thus created a rather high loss ratio as compared to earned premiums and total losses For example, if housing authorities had been paying $22.50 per unit, rather than the $7.50 per unit, the earned premium would have been $1,192,500 per year for a 3-year total of $3,577,500, reflecting a loss ratio of 0%. It appears then that a 300% increase in premiums would wipe out the loss incurred by the insurance company over the past 3 years. The 1600% increase in premiums, therefore, does not appear to be justified based on the loss experience encountered by the housing authorities over a three-year period.

4. The Committee briefly discussed the self-funded insurance program presented by Surplus Marketing. A motion to table the matter was made by Joe Laden and seconded by Martha Surprenant. Therefore, the proposal from Surplus Marketing Services was tabled by the Committee.

5. Options were discussed by the Committee and those present at the meeting with respect to Comprehensive General Liability needs. Items covered were as follows:

   a. The Chairman of the Committee was requested to contact the Conference of Mayors to discuss the system of coverage currently being used by municipalities and any State Legislation that may be pending regarding same.

   b. The Committee requested that Joe Leone, on behalf of NYSARHO, forward a letter to our Senators and Congressmen informing them of the problem the housing authorities are currently facing with respect to obtaining General Liability Insurance

   c. It was also suggested the Committee forward a letter to the Senators and Congressmen regarding the letter received by several housing authorities from William H. Connolly & Company with respect to the coverage their company had offered through Great Global Assurance Company and advising the housing authorities that their offer would not be extended to the September 23, 1985 period and that each housing authority, if they wish to have coverage must make their decision as soon as possible.

d. HUD's role was then discussed and Mr. Laden b ought to the attention of the Committee that there was a bill before Congress currently to allow for $50,000,000 to be funded to housing authorities for cost beyond control in compliance with PFS 990, which permits housing authorities to request from HUD additional funds to cover housing authority costs that were unanticipated and beyond the control of the housing authority, such as excessively high insurance premiums. It was requested that housing authorities support this bill with a letter to your Congressmen and Senators.

e. A discussion took place regarding NYSARHO as a possible agent for a self-funded insurance program. This proposal received general support from the Committee and those present at the Committee meeting, however, it was felt that this would be a possible long-term solution to the problem and that PHA's should not rely on this as a solution to our immediate insurance needs.

d. The possibility of a deductible on liability coverage was then discussed indicating that several housing authorities currently do have the authorization from their Boards to pay minor claims directly, rather than submitting them to their insurance company. Albany Housing Authority currently pays claims under $100 and Buffalo Housing Authority pays claims directly under $500.

g. It was recommended by the Committee that if a favorable group program is not forthcoming by the September 11th Committee meeting that it would most likely be the recommendation that housing authorities, on their own, each try to obtain coverage through whatever means are available. That being general coverage with a deductible or direct negotiation with a carrier and obtain total Comprehensive General Liability Coverage or signing with William H. Connolly & Company at approximately $120 to $123 per unit.

6. A letter was distributed from Fred S. James & Company of New England regarding Housing Authorities Public Official Liability Insurance (a copy of the letter is attached to the minutes). Included was a liability application form to be filled out by the housing authorities and forwarded to Fred S. James & Company for a quote on Directors and Officers Liability Coverage. An annual installment premium summary was included. (Also attached).

Before conclusion of the meeting, it was recommended that NYSARHO send a letter to HUD requesting a blanket waiver from the annual contributions contract for those housing authorities that are not able to obtain Comprehensive General Liability.

The next Committee Meeting was set for September 10th at 11:00 a.m. a the Schenectady Housing Authority, 375 Broadway.

7. The meeting was adjourned at approximately 12:15 p.m.

MINUTES: From Ad Hoc Insurance Committee (NYSARHO)

DATE: August 19, 1985

TIME: 10:30 a.m.

PLACE: Holiday Inn, Saratoga, New York

COMMITTEE MEMBERS:	Richard Kopke, Chairman	(Present)
	Marian Cauley, Assigned Director	(Present)
	Sal Convertino, Assigned Director	(Present)
	Myron Bender (DHCR)	(Absent)
	Joseph Laden	(Present)
	J. Donald Leahy, (Pres. NYSARHO)	(Present)
	Charles Patricelli	(Present)
	Sindey Schwartz (HUD Region II)	(Absent)
	Martha Surprenant	(Present)
	Ralph Leckey (HUD Central)	(Present)

The meeting was called to order by Richard R. Kopke, Chairman. In addition to the above mentioned committee members, approximately 20-25 interested NYSARHO Members sat-in on the meeting.

1. Presentation by R.R. Kopke, Committee Chairman regarding sample of NYS PHA's and their Comprehensive Liability status.
2. Presentation by Tom O'Callahan with HUD Regional Office in NYC.
3. Presentation by Ralph Leckey with HUD Central in Washington.
4. Presentation by Robert J. Power and James R. Kyle of Surplus Marketing Services of Boston, Massachusetts.
5. Group Discussion of insurance problems.
6. Recommendations by committee
7. Adjournment

A summary of topics covered is as follows:

1. <u>Sample: PHA General Liability Status</u>

The Committee Members polled by telephone some 30 PHA throughout New York State and found that a good number of smaller authorities have obtained independent liability coverage through Alexander & Alexander at $35 to $50 per unit and Connolly at $100 to $123 per unit. Several authorities have multi-peril policies with State Farm at a rate of $15/unit. The majority of PHA, however, have received proposals from Connolly at $100 to $123 per unit, Section 8 as well as Conventional Units and are waiting for further input from NYSARHO or HUD before signing policies.

2. Presentation by Tom O'Callahan, HUD Regional Office

Mr. O'Callahan (212-264-4971) indicated that he'd been working on alternative proposals for Comprehensive General Liability for PHA's with Coroon & Black and BRI and hoped to have something in writing by August 21, 1985. He felt that the best option currently available to PHA's was a combination of self-funded insurance with a deductible and excess liability coverage. He offered his services with respect to any questions PHA's may have on insurance and suggested the committee hear the presentation by Surplus Marketing Service and their proposal for a Self-Funded Program.

He agreed that very few options were available for liability insurance, especially for larger PHA's. He stated that his attempts to attract the interest of agents to secure coverage was resulting in the same response - that there is little or no interest in municipal clients.

3. Presentation by Ralph Leckey, HUD Central Office

Mr. Leckey (202-755-8145) has been working on the problem of limited interest by agents and insurance companies in writing municipal and PHA general liability prior to the bid opening at NYSARHO offices on June 19, 1985. As a result of his efforts, Mr. Leckey presented to the committee a HUD Guidebook on Self-Funding, Feasibility of Self-Funding Programs.

Mr. Leckey also offered HUD's services for the review of insurance company's proposals to PHA's and recommended that if PHA's could get full liability coverage at a reasonable price (under $50 per unit), they should take it. He further stated that if a PHA was unable to obtain coverage by the end of the extension of the NYSARHO blanket policy (September 23, 1985) the PHA must forward a request to HUD for a waiver from liability insurance for the ACC. This does not protect the PHA from possible losses but at least the PHA will not be in violation of their ACC which does state the liability insurance is mandatory.

Further, Mr. Leckey strongly suggests that all PHA's with Section 8 obtain insurance certificates naming the authority as insured for each Section 8 unit. The limits should be 500,000 to 1,000,000 if possible.

HUD long range approach to solving this problem is to form a HUD-sponsored program for all PHA throughout the country, but, of course, this will not take place by September 23, 1985.

4. Presentation by Surplus marketing Service of Boston

Mr. Power made a presentation on a Self-Funded Program whereby each member PHA would contribute a premium per unit to a "pool".

Losses incurred by any authority would be drawn from the pool up to $250,000 on an occurrence. Losses in excess of $250,000 would be covered by a commercial carrier from whom a policy would have been purchased with, in essence a $250,000 deductible. The premiums received would develop a pool of approximately $2 million by premiums as follows:

PHA's of 0 - 250 units @ 60.00/unit
PHA's of 250 - 1000 units @ 65.00/unit
PHA's of 1000+ units @ 70.00/unit
Section 8 @ 7.00/unit
Section 23 @ 15.00/unit

Mr. Power distributed the attached letter which further explains his company's proposal.

5. Group Discussion

Questions were then raised by those in attendance -

1. What about claims in excess of $1,000,000 under the Self-Funded Program?

2. What if one PHA drains the pool with a lot of claims?

3. Will HUD approve such a plan? Yes.

4. Will DHCR approve such a plan?

5. What other options are available.

6. Will HUD pay for excessively high premium rates?

7. Can PHA's be self insured?

These and may other questions could not be answered at the first committee meeting. It was suggested that the questions be put on hold until after Mr. O'Callahan has received the additional proposals referred to during his presentation.

6. Committee Recommendations

1. Follow-up meeting was scheduled for Tuesday, August 27, 1985 at 20 Warren Street, Albany, New York (Albany Housing Authority) at 11:00 a.m. to review Mr. O'Callahan's proposals.

2. Smaller PHA's with firm offers for liability insurance for $50/unit or less should purchase it.

3. Continue a PHA by PHA search for interested insurance companies to provide coverage.

7. Adjournment - 12:30 p.m.

Submitted by:
Richard R. Kopke
Richard R. Kopke
Chairman, Insurance Committee

New Members to Insurance Committee,

August 1, 1985

Mr. F. Joseph Leone, Executive Director
Nysarho, Inc.
State Office, 100 State Street
Albany, New York 12207

Re: Comprehensive General Liability Insurance -
A Proposal For Limited Self-Insurance
Funding and Excess Catastrophe Protection

Dear Mr. Leone,

A review of the loss experience incurred by participating members of Nysarho, Inc. in the Association's insured Comprehehensive General Liability program over the past 5 years, indicates that on attractive proposal for future coverage may be obtained by the use of a limited self-insurance program, Independently administered for the handling of the majority of claims, and the use of commercial excess insurance to limit the Association or individual Authority member's exposure to loss.

We believe a combined limit of coverage to a total of $1,000,000 per occurrence can be accomplished at a per unit cost of approximately $67.50 for conventional housing, with section 23 and section 8 being included at figures of $15.00 and $7.00 respectively.

From the general census figures included in the Bid Specifications, the following figures would be generated:

Class	Rate	No. of Units	Extension
Conv. - 1000+ Units	70.00	17,960	1,257,200
Conv. - 251 - 1000 Units	65.00	9,240	600,600
Conv. - 0 - 250 Units	60.00	2,915	174,900
Section 23	15.00	300	4,500
Section 8	7.00	5,632	39,424
		Total	2,076,624

P.T.O.

SURPLUS MARKETIN .VICE 99 High Boston Massachusetts 02110 Tel (617) 423-7408

These figures do, of course, contemplate the continued participation of all Authorities. We emphasize this point because the participation of management, adjusting firms and insurers will depend heavily on the volume of activity to maintain expense factors at an acceptable level, both to your organization and to their interests.

Coverage to be provided will be maintained in line with your bid specifications to defend and pay claims falling within the coverage provisions of Standard Comprehensive General Liability forms in use by the majority of admitted Insurors which does include the Owners', Landlords' & Tenants' hazards, and with basic form extended to include Broad Form General Liability Endorsement which affords Personal Injury Coverage (Employee Exclusion deleted), and Broad Form Contractual Liability, Independent Contractors' Liability and Products and Completed Operations Coverage, if any. The Coverage would include a sub-limit of $300,000 as respects Personal Injury claims. Non-Owned and Hired Automobile Liability would be added by further endorsement at the basic combined total figure of $1,000,000. No deductible would apply in the program.

Although some organizations are available to provide claims administration service, including the actual on-site negotiations or adjustment of claims, we would suggest that the record-keeping and payment of losses be separated from the actual adjustments for two principal reasons:

1) That each organization may serve as checks and balances to the other, and
2) so that local firms may be utilized to take advantage of their knowledge of local situations possibly influencing the final outcome or disposal of reported incidents.

As any program of Self-Insurance must be limited to an amount which the Association or group can reasonably be expected to absorb, we intend that loss per any one occurrence be limited to $250,000 including claims expense.

Any occurrence developing an exposure in excess of this amount will be stopped at this point and involve a commercial excess carrier for the next $750,000 to a total of $1,000,000 indemnity and claims expense.

As outlined earlier, the scope of the self-insured program will be strictly defined within the context of commonly used commercial insurance wordings, to not only express the intent of the basic program but also to define completely the exposure of the excess carrier.

P.T.O.

F. Joseph Leone - 3 - August 1, 1985

Individual billing of the housing authorities will be done by this offic with the actual change to each being dependent on a completed census form giving us the description by Project Number, Project Name, Street Address and number of units involved for Conventional Housing, and the count at Program inception of Section 23 and Section 8. These charges, in lieu of premiums, must be paid within 30 days of program inception, and participation by less than 90% of units scheduled in Bid Specifications will void the Program.

Assuming a total pool participation of $2,000,000, 15% of this amount will be used to purchase Specific Insurance for $750,000 Excess of $250,000 Self-Insured payment, including Indemnity and Loss Adjustment Expense. The Excess Insurance will include no Aggregate limitations.

The Excess carrier will be an admitted insurance company authorized to do business in the State of New York and carrying a Best's Insurance Rating of B+ or better. A specimen copy of the Excess Insurance wording will be submitted for review and approval by necessary agencies.

The remaining fund , which will be held in an Escrow account and will be subject to a 15% charge for loss administration and general administrative expenses, not including actual loss adjustment fees.

This will reduce the pool to $1,445,000 to be used for payment of settled claims and claims expens. This figure would have proved adequate to pay losses incurred in each of the 5 years ending August 1, 1984. It would provide, with the Excess Recove y, sufficient funds to pay average losses projected with 10% inflation an itill afford a cushion (beyond the average loss cost) for two major inciden which might involve Excess Insurance.

Any deficiency in the loss fund would have to be made up by further member contributions or a c with commercial Insurance coverage which would include another premium to be deducted from the fund.

We are currently researc ing the markets for an Aggregate Stop Loss Cover, which could come into play to limit the self Insurance Fund payout to 125% of expected losses, within the Self Insurance payout limit of $250,000. The cost and availability of this coverage will depend on our providing up-dated loss figures for the 5 years through 8/1/84 now available along with a summary of the immediate past year losses.

P.T.O.

Mr. F. Joseph Leone - 4 - August 1, 1985

In summary, we need up-dated loss experience, acceptance of the proposal in general terms by your office and subscription of your members to the proposal by completion and immediate return of the census forms enclosed, in order to enable us to firm costs and prepare necessary contract.

Yours truly,

SURPLUS MARKETING SERVICE

James R. Kyle

JRK:ph

Encl.

SCHENECTADY MUNICIPAL HOUSING AUTHORITY , N.Y.
OPERATING BUDGET FOR FISCAL YEAR ENDING 3/31/86
****

BUDGET ITEM	PROPOSED AMOUNT	REVISED
OPERATING RECEIPTS:		
INCOME FROM RENTS	$1,508,000	
INTEREST ON INVESTMENTS	$300,000	
TOTAL OPERATING RECEIPTS	$1,808,000	$1,808,000
OPERATING EXPENSES:		
ADMIN.& TENANT SERVICES	$395,000	
UTILITIES	$1,096,000	
MAINTENANCE (MATERIALS & LABOR)	$493,000	
PROTECTIVE SERVICES	$53,000	
INSURANCE	$70,000	$300,000
EMPL. BEN. & COLLECTION LOSSES	$285,000	
TOTAL ROUTINE EXPENSES	$2,392,000	$2,632,000
TOTAL OPERATING RECEIPTS	$1,808,000	$1,808,000
TOTAL OPERATING LOSS	($584,000)	($824,000)

PROBLEM: AN ADDITIONAL $240,000 UNPLANNED EXPENSE WILL RESULT IN SIGNIFICANT BUDGET CUTS.

RENTAL INCOME & INSURANCE COSTS
YEARLY COMPARISON
SCHENECTADY MUNICIPAL HOUSING AUTHORITY, N.Y.

BUDGET YEAR	RENTAL INCOME BEFORE SUB DY	COST FOR ALL INSC.	COST/UNIT /MONTH	% OF INCOME
1986	$1,508,000	$300,000	$23.92	19.9%
1985	$1,377,000	$49,910	$3.98	3.6%
1984	$1,227,000	$45,645	$2.64	3.4%
1983	$1,249,000	$57,559	$4.59	4.6%
1982	$1,275,000	$44,893	$3.58	3.5%

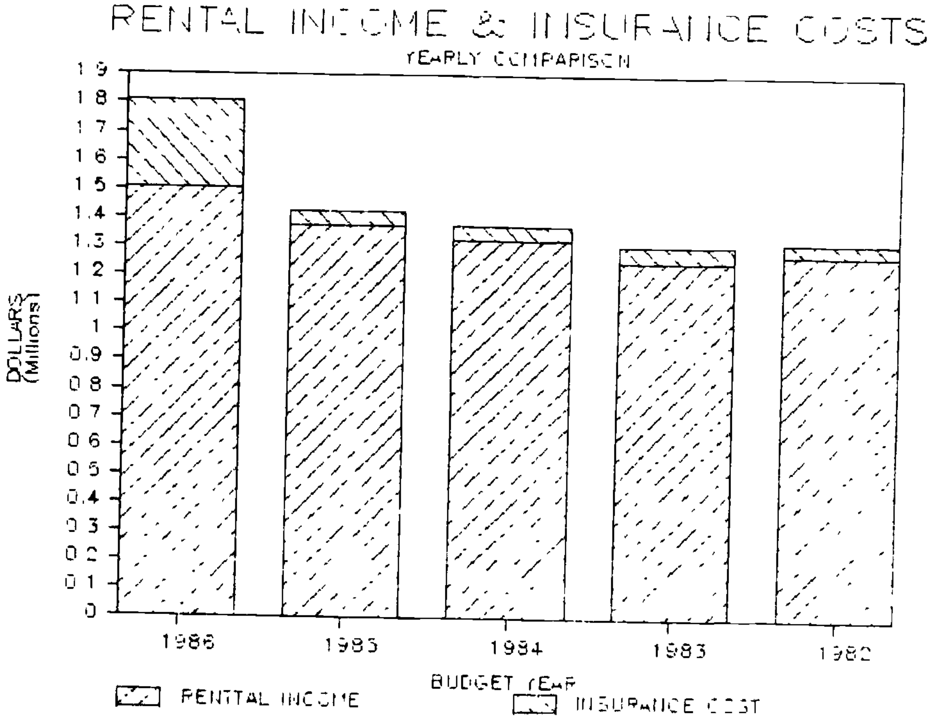
NOTE: THERE HAS BEEN A 601% INCREASE IN THE PREMIUM COST FOR ALL PHA INSURANCES IN 1986.

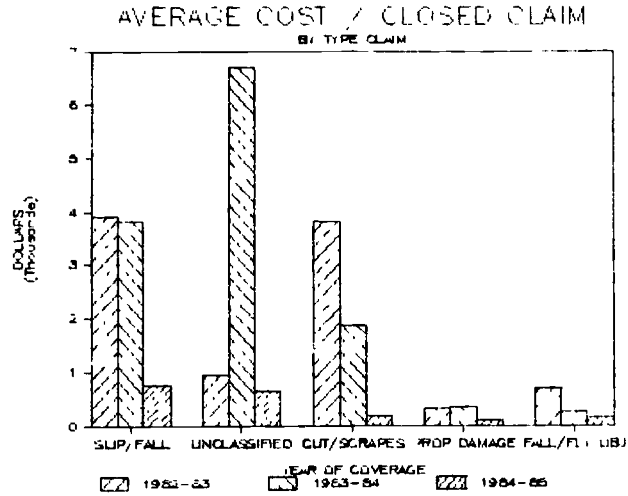
FAST INSURANCE COSTS FOR COMPREHENSIVE GENERAL LIABILITY:

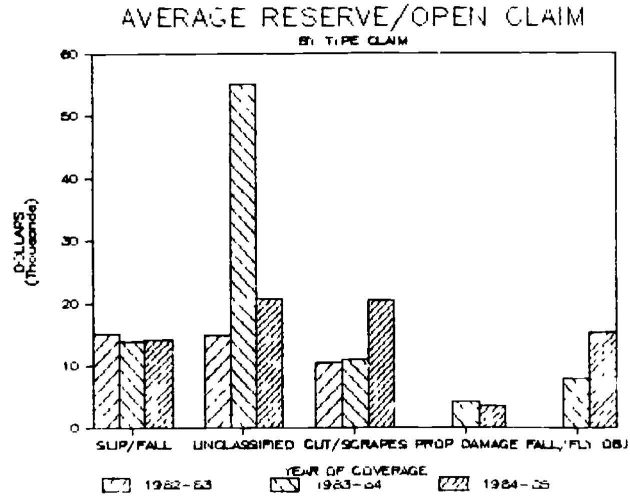
2/1/78 - 3/1/81 EMPIRE MUTUAL INS. CO.
$500,000/$1,000,000
$19,848/YEAR PREMIUM
$21.45/UNIT/YEAR AVERAGE

8/1/82 - 8/1/85 ZURICK INS. CO.
$1,000,000 PRIMARY
PACIFIC EMPLOYEES INS. CO.
$5,000,000 EXCESS
$14,238/YEAR PREMIUM
$8.36/UNIT/YEAR AVERAGE

8/1/85 - 8/1/86 GREAT GLOBAL INS. CO. (PROPOSED)
$1,000,000 PRIMARY
$221,000/YEAR PREMIUM
$122.00/UNIT/YEAR AVERAGE
1500% INCREASE IN PREMIUMS OVER 1985


RENTAL INCOME & INSURANCE COSTS
YEARLY COMPARISON
DOLLARS (Millions)
1.9
1.8
1.7
1.6
1.5
1.4
1.3
1.2
1.1
1
0.9
0.8
0.7
0.6
0.5
0.4
0.3
0.2
0.1
0
1986
1985
1984
1983
1982
BUDGET YEAR
RENTAL INCOME
INSURANCE COST


AVERAGE COST / CLOSED CLAIM
BY TYPE CLAIM
DOLLARS (Thousands)
0
1
2
3
4
5
6
SLIP/FALL
UNCLASSIFIED
CUT/SCRAPES
PROP DAMAGE
YEAR OF COVERAGE
1963-84
1984-85


AVERAGE RESERVE/OPEN CLAIM
BY TYPE CLAIM
DOLLARS (Thousands)
0
10
20
30
40
50
60
SLIP/FALL
UNCLASSIFIED
CUT/SCRAPES
PROP DAMAGE
YEAR OF COVERAGE
1982-83

NEW YORK STATE PUBLIC HOUSING AUTHORITIES (60 PHA'S)
COMPREHENSIVE GENERAL LIABILITY INSURANCE
RISK EXPERIENCE SUMMARY 8/1/82 TO 8/1/85

TYPE CLAIM	1982 - 1983 CLOSED	#	OPEN	#	1983 - 1984 CLOSED	#	OPEN	#	1984 - 1985 CLOSED	#	OPEN	#
SLIP/FALL	$3,920	44	$14,970	6	$3,814	25	$13,846	34	$746	11	$14,045	41
UCLASSIFIED	$948	19	$14,800	5	$6,718	22	$55,132	22	$649	8	$20,624	15
CUT/SCRAPES	$3,822	6	$10,500	1	$1,880	5	$10,833	3	$187	2	$20,442	3
PROP DAMAGE	$313	8	$0	0	$346	6	$4,188	2	$97	1	$3,520	4
FALL/FLY OBJ	$702	2	$0	0	$272	3	$7,942	3	$140	1	$15,373	5
CLAIMS/YEAR	CLOSED	79	OPEN	12	CLOSED	61	OPEN	64	CLOSED	13	OPEN	68
TOTAL CLAIMS PROCESSED			1982-83	91			1983-84	125			1984-85	81
TOTAL CLAIMS $0			1982-83	57			1983-84	85			1984-85	35
TOTAL CLAIMS MADE			1982-83	148			1983-84	210			1984-85	116

7M241

ZURICH-AMERICAN INSURANCE COMPANIES

N Y STATE HOUSING
ANALYSIS PERIOD 08/01/82 TO 07/01/85

RESK EXPERIENCE REPORT

PNOUUCER KERWICK & CURRAN LNC
CLAIMS VALUATION AS OF: 07/85

RISK EXPERIENCE SUMMARY

GENERAL LIABILITY

EXPERIENCE PERIOD(S)	EARNED PREMIUM	RETRO PREMIUM	NUMBER OF CLAIMS	PAID	EXPENSES	OPEN RESERVE	TOTAL	LOSS RATIO
08/01/82 - 08/01/83	394,941	0	148	169,091	52,194	170,337	391,623	99%
08/01/83 - 08/01/84	391,027	0	210	295,485	58,140	1,670,815	2,024,441	517%
08/01/84 - 08/01/85	393,283	0	116	52,702	23,985	971,804	1,048,493	266%
TOTAL	1,179,252	0	474	517,278	124,320	2,812,958	3,464,558	293%

TOTAL ALL COVERAGES

EXPERIENCE PERIOD(S)	EARNED PREMIUM	RETRO PREMIUM	NUMBER OF CLAIMS	PAID	EXPENSES	OPEN RESERVE	TOTAL	LOSS RATIO
08/01/82 - 08/01/83	394 941	0	148	169,091	52,184	170,337	391,623	99%
08/01/83 - 08/01/84	391,027	0	210	285,485	58,140	1 670,815	2,024,441	517%
08/01/84 - 08/01/85	393,283	0	119	52,702	23,985	971 804	1,048 483	266%
TOTAL	1 179 252	0	474	517 279	124,320	2,812,858	3,464,558	393%

U. S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

REGION II, NEW YORK

NOTICE BUF 79-57

August 8, 1979

7401.5

TO: ALL PHAs

Expiration Date: February 8, 1980

SUBJECT: NYSARHO GROUP LIABILITY INSURANCE POLICY FOR PUBLIC HOUSING AUTHORITIES

The New York State Association of Renewal and Housing Officials has awarded a contract for New York Master Public Liability Insurance coverage to the Guarantee Insurance Company. All PHAs may participate in this group policy which provides the following coverage:

Bodily Injury Protection/$1,000,000 limit per occurrence
Owners, Landlords and Tenants
Manufacturers and Contractors
Personal Injury (Liable, Slander, False Arrest/Naming the Board of Commissioners as additional insureds)
Broad Form Contr-ctual
Independent Con actors

The policy has been awarded on a three year basis. All participating PHAs will pay annual premiums computed on the following rate schedule:

ANNUAL RATE PER UNIT*

Group Size (Units)	Conventional	Section 23	Section 8
0-250	$ 5.105	$ .50	$.250
251-1,000	$ 7.254	$ .75	$.375
1001-up	$10.769	$1.00	$.500

*Include each Community Room, Community Building, Park or Playground as one unit for rating purposes.

Any PHA who joins this Master Policy will have met the open and competitive bidding requirement of Part II, Section 305 of your Annual Contributions Contract in so far as it concerns Public Liability insurance. Upon receipt, the Authority need only submit one copy of the Certificate of Participation to this office for approval.

2.1HMA:Distribution: All PHAs

231319-P HUD-Wash., D. C. HUD-718

2

We request that all PHAs consider the Cost benefit of joining this Master Policy. The only justification for not joining this policy would be your ability to obtain similar coverage at the same or lower cost.

Any questions concerning this matter should be directed to our Assisted Housing Management Branch at (716) 846-5714.

STATE OF NEW YORK
DIVISION OF HOUSING AND COMMUNITY RENEWAL
TWO WORLD TRADE CENTER
NEW YORK, N.Y. 10047

VICTOR MARRERO
COMMISSIONER

RECEIVED
JUL 3 1979
MUN HSG. AUTH.
SCH'DY, N.Y.

June 27, 1979

Management Bureau Memorandum #79-A-3

To: All Housing Authorities Operating State-Aided Projects

From: Melvin Julie, Director
Housing Management Bureau

Subject: Insurance

Our review of the bid procedure used by NYSARHO, Inc. for comprehensive general liability insurance found it to be in compliance with our competitive bidding requirements of Section 1630-1.1 of 9 NYCRR.

The specifications were limited to a request for premium quotations for comprehensive general liability insurance. If you are now covered by a multi-peril package policy and wish to participate in the NYSARHO Inc. program, you will have to obtain the other coverages through separate insurance policies.

For further details of this program please contact:

Mr. F. Joseph Leone, Executive Director
NYSARHO, Inc.
100 State Street
Albany, New York 12207

cc: Mr. Fy3-
Mrs Mahoney
2 xtra copies/Rose
Reg - Insur
7-3-79

Melvin Julie

State agencies clash over municipal insurance reform

By E.J CONZOLA II
Binghamton Bureau

Gov Mario M Cuomo is considering taking the initiative on the municipal liability insurance crisis, but he is getting conflicting recommendations from state agencies, the chief examiner for the state Insurance Department said yesterday

Cuomo is thinking about entering the debate on the liability insurance question either through introducing his own bill in the state legislature or through supporting one of the numerous proposals put forth by legislators, said Henry L. Lauer

However, while Insurance Department officials are arguing for reforms in the legal system, officials of the state Attorney General's Office and state Consumer Protection Board are arguing against any changes that would place a limit on the size of court awards, he said

Lauer made his comments after a meeting with the Southern Tier East Regional Planning Development Board At that meeting a number of municipal officials told of problems they have had obtaining affordable liability insurance, statements that have been echoed throughout the state recently

Limiting the size of monetary awards is the thrust of several bills that the legislature will be discussing probably when they are called into special session in November, Lauer said

Other bills expected to be discussed include provisions that would limit the percentage of an award a municipality can be held responsible for, permit municipalities to form private insurance pools, and tighten regulations governing rate-setting by insurers, he said

Bills that would have enabled municipalities to create insurance pools eliminating the need for commercial insurance coverage and that would have stiffened regulations governing the issuance of insurance policies were approved by the Assembly during the last legislative sessions but died for lack of Senate action, Assemblyman James R Tallon Jr., D-Binghamton, said Wednesday

The Insurance Department is recommending that any reform package include a change in the doctrine of joint and several liability, under which a municipality can be forced to pay the entire cost of a court award even though it was found by a jury to be only partially liable for the situation that prompted the lawsuit Lauer said

SUN BULLETIN September 6, 1985

Local

The Sun-Bulletin /Thursday, September 5, 1985 (Binghamton) 3A

Liability crisis traced to courts, insurors

By E J CONZOLA II
Binghamton Bureau

Any solution to the growing crisis in municipal liability insurance must deal with both the court system and the insurance industry, Assemblyman James R. Tallon Jr told a group of municipal officials yesterday

"No single solution is the answer," the Binghamton Democrat said during a forum on municipal tort liability at the Binghamton Town Hall.

The forum, sponsored by Town of Binghamton Supervisor Kenneth Lee Cline, attracted more than two dozen municipal officials from throughout Broome County

Several officials told of problems in trying to find an insurance carrier to provide liability insurance for their communities.

Most carriers simply refuse to insure municipalities, while those that do are charging rates several hundred percent higher than the rates charged the previous year, officials agreed.

Tallon said the current crisis has been approaching for years, and is at least in part the outgrowth of insurance industry practices in the 1970s.

Insurance companies lowered their standards for providing insurance during the 1970s in an effort to gain more clients, who would pay more premiums that could be invested at the high rates of interest prevalent at that time, Tallon said Those high returns more than offset any discounts offered to attract new business and any payments made because of poor risks, he said

However, now that investment interest rates have dropped, insurance companies are finding their old practices are unprofitable, he said. The insurance companies "overly extended themselves" and are now trying to retrench by dropping one of their most costly programs, municipal insurance, he said

Tallon also blamed the court system in part for the current crisis.

Over the years, the courts have expanded the area of municipal liability, making local governments responsible for things they were never responsible before, Tallon said

Tallon said he supported a bill introduced in the most recent Assembly session that would have enabled municipalities to "pool" their funds to create a sort of private insurance company Such a pool would permit governments that could not find commercial insurance to spread the cost of potential liabilities over a broader monetary base through a sort of private insurance group, he said

The bill was approved by the Assembly, but was not acted on in the Senate

Tallon also said the legislature should explore revisions in regulations which force municipalities to cover any percentage of a court award the other defendents cannot cover, even if the municipality was found to be only partly responsible for an incident that led to a suit

Tallon also suggested that the Appellate Division of state Supreme Court be given greater powers to review monetary awards handed down by juries in lawsuits involving municipalities

Tallon said it is possible the legislature will take up the municipal liability question if it is called back into session in November, but said he does not expect any action to be taken until the 1986 legislative session

Municipal insurance rates soar; 'catastrophe' predicted

By JERRY GLEESON

If Elmirans want to see how liability insurance problems are plaguing their city and others across the state, all they have to do is look at the rear of City Hall.

Rising three stories high is a cinderblock emergency staircase, its rough concrete exterior contrasting sharply with the elegant French Renaissance facade of much of the rest of the late 19th-century building.

A long-simmering debate over whether the staircase should be built came to a head last spring, when the city's insurance carrier, Insurance of North America, threatened to cancel Elmira's liability policies if the stairway wasn't built by June 15.

The city and its insurer had their staircase by the deadline, at a cost of $[illegible]. City Manager John C. Gridley has said facade work will be completed on the staircase when overdue state aid arrives on the construction costs.

The difficulty in obtaining liability insurance this year hastened the stairway's progress, city officials agreed.

Elmira insurance agent Robert Carroll, president of the Professional Insurance Agents of New York State, has warned that a "potential catastrophe" in municipal insurance is brewing in the state.

At least 26 major insurance carriers in the organization no longer write policies, have increased premiums, or set new restrictions on coverage.

The results have been costly for city taxpayers:

- In one year, insurance coverage for the City of Elmira increased 83 percent, chiefly through liability rate hikes. The 1985 insurance cost $[illegible], an increase of $[illegible] over last year.

- The Elmira City School District will pay $[illegible] for $[illegible] million in liability coverage in the 1985-1986 school year. Last year the district paid $84,000 for $10.5 million in coverage to the same company.

Insurance agents blame the skyrocketing costs on burgeoning jury awards, growing litigation, and price wars that sharply reduced premiums two years ago. In 1983, for example, the city's insurance costs dropped by $22,300, to $118,100.

"The market was very competitive back in 1983," said City Chamberlain Lawrence Kay. "That's why we were able to negotiate such a significant reduction."

Much has changed in two years, however. When Elmira sought bidders last year for its insurance business, only two companies responded. "It's a bargain at whatever price you can buy it," Kay said.

City and school district officials say they have a good history of claims with their insurance carriers, although the city was hit with two claims totaling $55,000 last year when two fire trucks were damaged in separate accidents.

"Is that bad? I guess that's relative," said Mark Hagan, account executive for Perry and Swartwood, the city's insurance agent. "You expect to have one of those weird accidents once in a while. But overall their experience is good."

The bad claims history of several municipalities will cause premiums to rise for all, Hagan said. "That's a function of the market place," he said. "You don't have to have a poor claims record in order to have an increase in premiums."

School district Business Administrator Francis Weeks said the Hartford Company, which writes the district's liability insurance, refused to sell the same amount of coverage despite the district's "very good" claims history.

The district is seeking additional coverage through other companies because $10.5 million is what attorneys recommend the district carry, Weeks said.

The district's total insurance budget for 1985-1986 has risen from $135,000 to $253,00. Among other items, the district needs liability insurance on its fleet of 73 buses, cars, and maintenance vehicles, Weeks said.

'The market was very competitive back in 1983. That's why we were able to negotiate such a significant reduction.'

'Today it's a bargain at whatever price you can buy it.'

City Chamberlain Lawrence Kay

Kay said he couldn't predict what the city will pay for insurance in 1986, or the effect on insurance rates of at least four lawsuits that have arisen from the January 1984 Jones Court shootout.

"I'm sure it wouldn't make it easier," Kay said of the shootout, in which one police officer and two parolees were killed, and two other officers were injured.

A liability self-insurance fund similar to the city's self-insurance fund for city workers, is unfeasible unless the city joined a pool of many other cities, Kay said.

"All it takes is one catastrophic incident to force the city into a fiscal crisis," he said.

EVENING PRESS August 29, 1985

John D. Lake Sr

Insurance troubles housing officials

By MICHAEL K. GORMLEY
Binghamton Bureau

Major public housing authority leaders in the state huddled this week to find a savior from insurance rates shooting beyond the reach of their budgets.

One big-city housing authority official in a private huddle this week reportedly said, "Prepare for the worst."

That's what was said at the meeting Tuesday in Albany, said Binghamton Housing Authority Executive Director John D. Lake Sr., who attended. Officials from housing authorities in Buffalo, Utica, Schenectady and Lackawanna also attended, Lake said.

A spokesman for the federal Housing and Urban Development Department — the housing authorities' major provider — failed to attend as planned. Lake said HUD and the New York State Association of Housing and Renewal Officials are continuing to negotiate with insurance companies for coverage. The meeting this week included several members of the association's insurance committee, Lake said.

Lake said the Binghamton authority is negotiating with its insurance company, Aetna Life and Casualty Co., as well as advertising for other companies' proposals. The authority board learned Aug. [illegible] that its liability insurance premium will quadruple to more than [illegible].

Lake said HUD must approve insurance premiums before they are paid by the housing authority with federal money. He said the situation's severity is evident in that HUD has allowed housing authorities to accept any insurance offers that fall under a specific cost without advertising for bids or securing formal approval by HUD. Lake declined, however, to say what that ceiling cost is or if it is significantly higher than premiums before the increases.

A reporter who was told about the private meeting spoke with an Albany Housing Authority official before the session, but was not allowed to remain for the meeting, apparently in compliance with state Open Meetings Law.

The problem of liability insurance premiums rising several hundred percent has the Binghamton Housing Authority scrambling to find some insurance before the current extension expires in the last week of September, Lake said.

The problem is affecting all housing authorities and municipalities, said Joseph F. Lader, Albany Housing Authority executive director and past national president of a housing officials association. He said his authority's insurance cost increased by 1,[illegible] percent and called the common problem "extreme."

Insurance company spokesmen have said the rate increases are to help recover losses from insuring governments and related agencies. They said governments are being sued more often and large court-ordered awards have been levied regularly, making the municipalities and authorities high risks.

For Binghamton city government, the cost of liability and motor vehicle insurance would double, from $[illegible] in 1984 to about $[illegible] for 1985, if the city could get a company to agree to take the policy.

For Broome County, the premium increased by [illegible] percent to as much as $[illegible] a year.

Evening Press 8/29/85

SUN BULLETIN August 29, 1985

Day care fees reflect rising insurance

By ADELLE M BANKS
Staff Writer

Day care center operators faced with increased insurance rates are finding they must raise tuition to continue providing care for some children in Broome County

Joni L Frisbie, executive director of the Wee Care Day Center, 607 Main St, Johnson City, watched the center's insurance rates climb in April from $250 a month to $600 a month for $1 million of coverage As a result, Frisbie said the center will be forced to charge monthly rates rather than daily rates "to even out the cost"

All-day care for infants and toddlers, for instance, used to be $13 per day, now, that service will cost $285 per month The center offers half-day and all-day care for 60 infants, toddlers and pre-school children

"We have lost a few (customers) already, unfortunately," Frisbie said of the rate hike, which goes into effect on Sept 1 Frisbie's independent insurance agent has guaranteed her that he will find her another agent when her policy expires in April, but she said, "He said it'll probably be more than what I'm paying now"

Of three other day care center operators interviewed, one said she planned to raise fees as a result of increased insurance premiums Two were facing no immediate premium increases, they said

Sandra R Schoonmaker, director of the Kid Korral Day Care Center Inc, 425 Robinson St, Binghamton, said she is expecting a 40 to 50 percent increase in her premium rate when she renews her policy in September On Sept 2, the center will have to raise parent tuition by 60 cents a day, she said The new tuition will range from $48 to $73 for a five-day week, based on a sliding scale that depends on family income

"I have had no one withdraw," she said of the center, which can serve 38 children "We tried to keep the raise as reasonable as possible"

Schoonmaker said she thinks the increased insurance rates, a national problem, are due not only to some companies reacting to reports of child abuse in day care centers, but also to increased claims filed for child injuries occurring at centers She said she would like to see a ceiling placed on the kinds of claims people can make and the amount of settlements they can receive

Nanda Cook, director of the Endicott Day Nursery, 1706 Monroe St, Endicott, and Timothy Stephenson, director of the Day Nursery Association, 32 Stuyvesant St and 320 Clinton St, Binghamton said they have not yet had to raise rates because of increased premiums

One agency refused to renew Cook's policy in May, but she found another insurer who was willing to insure her for three years Stephenson said his center is budgeting a 100 percent increase for insurance next year, when he expects rates will total $3,000 rather than $1500

Frisbie said, "I think there should be some type of a regulatory agency" She plans to meet with other day care center operators in the fall and "do what the doctors did – knock on doors" "If nothing is done about it, I won't be able to continue my business," she said.

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Utica, N.Y., Tuesday, August 27, 1985

Daily F.P.

State facing insurance nightmare, agents say

By JEFFREY STINSON
Gannett News Service

ALBANY — New York faces an "insurance nightmare" as government and business join doctors in having increased problems getting liability coverage, the state's independent insurance agents said yesterday.

"What we have here is a potential catastrophe," warned Robert Carroll, president of the Professional Insurance Agents of New York State, "with the consumers of this state either left entirely unprotected in many commercial coverages or facing tax increases and professional fees beyond belief."

Carroll, an Elmira agent, said businesses, professionals and local governments are being hit with premiums doubling, tripling or even quadrupling in price — when they can get liability insurance at all.

"In many cases, coverage isn't available," he said. "And when it is, it costs up to 400 percent more than just a year ago."

The group found from surveying its 2,500 members that at least 26 major insurance companies no longer write policies, have increased premiums or otherwise set new restrictions on coverage.

Among the areas of the economy hardest hit are restaurants that serve liquor, truckers, dentists, auto dealers, day-care centers, manufacturers, cities and schools, the survey found. Because of judgments, tort law and the riskiness of their business, these groups are sued more often.

"What insurance companies are doing is either not writing the coverage or placing such high premiums on (the policies) that they cannot be afforded," Carroll said.

The crisis — brought on by ever higher jury awards, a mountain of new

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INSURE

Continued from Page 1

and expensive litigation and the effect of many insurance companies having indulged in premium pricing competition six years ago — is prompting independent agents to seek immediate state intervention.

The independent agents, who sell the bulk of the coverage in the state, are asking the state Insurance Department to ban mass cancellations of policies by insurance companies, require companies to provide at least 60 days' notice to insured parties that their coverage will be canceled and 30 days' notice of premium hikes.

The group's findings coincides with findings of a study of a ballooning crisis in liability coverage for municipalities and school districts released this spring by the Assembly Local Government Committee.

The committee study found that 11,296 suits seeking more than $25 billion in damages were pending against all local governments in the state except New York City, which faces 19,036 actions seeking a total of $53 billion in claims.

Policies for more than 226 municipalities were canceled this summer; cities such as Binghamton and Saratoga Springs watched as premiums jumped two- or three-fold. Binghamton's annual liability premium went up 183 percent this year to $822,000. Saratoga Springs went from $109,871 last year to $349,833 this year.

At the same time, legislators this year began grappling with a much-publicized medical malpractice crisis, in which New York doctors were hit with a 52 percent premium hike and potentially face another one.

"The commercial and municipal liability field is going to make medical malpractice look like a picnic," said Michael Conners II, an Albany agent and president-elect of the independent agents association.

State Insurance Department spokesman Kevin Foley agreed New York indeed approaches a crisis in liability insurance, but said the state needs to look at more long-term solutions to the problem. He said the department would consider the proposals, however.

Conners acknowledged that the proposals don't get to the heart of the problem, but will buy time for business and government until the Legislature can find a way of easing the crisis.

EVENING PRESS August 27, 1985

Municipalities are warned of crisis with insurance

ALBANY (AP) — The head of an insurance agents' group warns that local governments and small businesses are threatened with "a potential catastrophe" because of high insurance rates and an inability to get insurance.

The group is proposing the state's insurance department take a series of actions to slow down rising insurance rates.

"The state is facing an insurance nightmare, with the first shock waves of the crisis already being felt," said Robert Carroll, president of the 2,500-member Professional Insurance Agents of New York State Inc. "In many cases, coverage isn't available and even if it is it costs up to 400 percent more than just a year ago."

Insurance rates have skyr[illegible]ed in part because of a growing number of laws[illegible] [illegible]d big damage awards handed down by courts, said Carroll, of Elmira.

"When cities and school districts can't find a company to write a liability policy for them, they have no insurance in the case of a lawsuit," Carroll said Monday. "With multimillion dollar awards being commonplace today the cost then comes back to the residents of that locale. The money has to come from somewhere, and without insurance that somewhere is from the taxpayers."

The City of Binghamton faced a 100 percent increase in premiums and then opted for a form of self insurance. Broome County faced a 400 percent increase and its officials also adopted a self insurance plan. Several other towns and villages have dropped, or had their policies cancelled, and their officials are hoping their governments are not sued.

Carroll's proposals are designed to make it harder for insurance companies to cancel insurance coverage and would require the companies to give greater advanced notice of plans to hike rates, not renew policies and end contracts with insurance agents.

State Insurance Department spokesman Kevin Foley said Carroll was correct in describing the seriousness of the problem of high insurance rates and lack of coverage.

However, Foley said that Carroll's proposals aren't far-reaching enough to get to the root causes of the problem.

"We're taking these recommendations seriously, but the larger questions of making coverage available and affordable aren't addressed in the recommendations," Foley said. "Our department is now conducting a rather large study of the entire liability insurance question. We don't want to make changes before we know what changes are necessary."

Foley said the Legislature may take action this autumn on proposals to give local governments greater protection against lawsuits.

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Insurers Blame Juries, Law For Municipal Policy Crisis

By MARGARET SULLIVAN

For municipalities in Western New York, across the state and throughout the nation, the skyrocketing cost of liability insurance has reached what many are calling a crisis level.

"It's basically an availability crunch and an affordability crunch," said Kevin Foley, spokesman for the state Insurance Department.

For local municipal bodies, the crunch has been painful. The most dramatic example is the Niagara Frontier Transportation Authority, where bus-insurance premiums jumped this month from $30,000 to nearly $500,000 annually — 1,566 percent — even though the authority has not filed a single claim in 40 years of operation.

Insurance industry spokesmen say the problem is the result of a legal system that has gone out of control, with juries awarding huge damages in accident cases.

"It's very difficult to control the losses that a municipality can have, in this very lawsuit-oriented society," said Michael C. Austin, acting manager for corporate communications for Utica National Insurance Group.

Utica Mutual, formerly the largest insurer of municipalities in New York State, stopped renewing most kinds of municipal insurance on Aug. 1. The company still is insuring such governmental bodies as transit authorities and school districts, but it has discontinued renewals on cities, counties and towns.

"MUNICIPAL INSURANCE used to be a profitable business for us," said Robert A. Sherman, underwriting manager for the company's Eastern regional office. Over the past four years, however, it has lost $1.30 to $2 for every dollar it took in in premium payments, he said.

Assemblyman Dennis Gorski, D-Cheektowaga, whose committee on local governments recently released a report on the problem, said that at the root of the problem is a public belief that "municipalities have deep pockets — virtually unlimited resources."

The result has been that many municipalities are finding it difficult to get any insurance at all. Those that can get it are finding that the cost has doubled, tripled or increased even more dramatically within the past year.

Municipal Liability Insurance:

Examples of Rising Premiums

	1984	1985	% Increase
Niagara Frontier Transportation Authority	$30,000	$500,000	1566%
East Aurora School District	$33,000	$68,000	106%
Town of Amherst	$550,000	$1.5 m.	172%
Buffalo Sewer Authority	$70,000	$288,000*	311%
Niagara Falls School District	$161,582	$433,784	168%
Cattaraugus County	$162,500	$745,948	359%
Erie County (excess liability)	$200,000	$1.85 m	825%

* chose to self-insure as a result of higher proposed premiums.

Local examples abound. Last week, the Niagara Falls Board of Education accepted the only policy available to it. Its current carrier, National Union, has withdrawn from the education market in the state.

The policy will provide "a lot less insurance for a lot more money," said Roy W. Rogers, administrator of school business services. The cost will rise from $161,582 to $433,784.

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Premiums

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State Insurance department spokesman Kevin Foley said the legal system is not the only reason for the problem, although it is contributing to it.

"The insurance industry is screaming for court reform, but there is also a market condition at work here," he said.

The market condition, he said, has its source in a price war that has been waged among property and casualty companies for six or seven years. It resulted in artificially low premium prices and a dependence by the insurance companies on high interest rates to make their profits. During that period, many insurance companies accepted policies unwisely, Foley said.

WHEN INTEREST rates fell and claims began to come in, many of the companies sustained large losses. Nationally, he said, the insurance industry lost $4 billion last year. Within New York State, 10 percent of insurance companies are in "serious financial condition," and the state has taken over two companies that were on the verge of collapse, Foley said.

The industry, in the face of all that, is now "adjusting its price structure," Foley said.

"The industry wants the state to change the situation, but we don't know if they are overreacting," Foley said. "This may be in part a market condition that will correct itself."

In the meantime, local municipalities — and taxpayers — will continue to pay drastically higher liability premiums.

The Cattaraugus County Legislature, for example, earlier this summer was forced to approve the payment of premiums that were 359 percent higher than last year. "We have a gun pointed at us," said Legislator Patricia McGee, R-Franklinville.

As a result, some municipalities have chosen to insure themselves. These include Amherst, where increases amounted to 172 percent, the Buffalo Sewer Authority (311 percent), and, probably, Erie County (excess liability premiums up 825 percent).

In other parts of the country, the situation is worse. In Point Arena, Calif., the mayor and a city councilman resigned this month after the town's insurance policy expired, fearing that they might be held personally liable for claims against the town.

Some towns across the country are cutting the risk of accident claims by curtailing services.

Among the solutions proposed by some members of the State Legislature is an effort to have municipalities pool their resources and insure themselves as a group. Gorski has suggested limiting municipalities' exposure by modifying the "joint and several liability" doctrine.

The doctrine means that any one of the defendants in a lawsuit can be held liable for the whole amount of the damages even though responsible for only a portion.

"We've got to do something," Gorski said. "We're really in trouble over this."

EVENING PRESS August 25, 1985

Insurance hurts coffers, officials say

By MICHAEL S GORMLEY
Binghamton Bureau

There's a black cloud looming over municipal financial planning these days caused by insurance companies that are increasing premiums several hundred percent or making wholesale cancellations say some government officials

Insurance companies say government is a bad risk and are opting to do away with that high risk even if it means losing a municipal policy holder

Government officials say the insurance industry has a like-it-or lump it attitude, and are facing the choice of spiraling premiums self insurance or the potentially costly threat of no insurance

Consumer advocates, including Ralph Nader say the rate increases are a ploy, possible collusion among insurance companies to increase profits while reducig risks He wants a federal investigation

"It is in a state of crisis," said John D Lake Sr, executive director of the Binghamton Housing Authority who learned this week his agency's premiums are quadrupling to $100,000 from $25,000

The City of Binghamton was facing a 100 percent increase in its premiums until it opted for self insurance Broome County officials, facing a 400 percent rate increase, also turned to self insurance Several other towns and villages in the Southern Tier have paid premium increases of several hundred percent or have chosen to drop liability insurance and cross their fingers The problem is national Dallas Texas and Baton Rouge La, dropped liability insurance because premiums rose 400 to 1,000 percent, according to *City & State* magazine

The impact on taxpayers, municipal officials said is a higher cost of insuring government or the potential of a multi million dollar lawsuit loss, which would be paid in full by the municipality

How do the insurance companies substantiate increases of up to 1,000 percent? Is it a plot?

"Emphatically no," said Edward O Hare, vice president of the Insurance Information Institute, a national advocacy group for the insurance institute

He said tremendous competition among insurance companies in recent years forced them to offer less than cost premiums resulting in an industry wide loss of $3.8 billion last year The huge increases now being charged recover some of those losses he said

"The industry as a whole has lost money the last several years they were all caught up in a very competitive period" O Hare said

Also more lawsuits against municipalities and larger awards made by courts when the municipalities lost have forced insurance companies to demand higher premiums to cover these costs, he said

He said there also are court deci

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Insurance

Continued from 1B

sions that have broadly redefined insurance policies, new definitions for which premiums never were collected

An example is long term or delayed payments for pollution damages or injuries and the belief that municipalities and insurance companies have "deep pockets" to pay steep punishments, O Hare said

"Until there is some cap on lawsuits and the size of awards municipalities will be very unattractive" to insurers, O'Hare said

However, the premium increases are not intentional ploys to force legislation to regulate awards caps, he said

Edgar B Parsons of Binghamton, an Aetna Life and Casualty Co agent handling the policy with the Binghamton Housing Authority said Monday the insurance companies are to blame for the increases because they are run by financial experts, rather than insurance experts

Municipal policies are split up into classifications regardless of the municipalities past insurance record somewhat like driver insurance Male drivers of a certain age are charged higher premiums because they are considered a higher risk than women of that age, or men of an older age group regardless of their past driving record

Parsons said today's major insurance company executives look at a municipality's or an agency's classification and, if it's a high-risk category, charge steep premiums or drop the policy regardless of whether the policy holder is a good risk within a high risk category

This shouldn't be, Parsons said An insurance expert would seek a good risk - like the Binghamton Housing Authority - within a high risk classification like housing authorities in general He said insuring the Binghamton Housing Authority at a reasonable price and covering its small losses of less than $2,000 a year is the way to make money in insurance

Part of the answer for lower premiums could be arbitration to settle legal disputes, O Hare said He said the cost of insurance is directly related to court costs to defend municipalities The fewer court appearances, the lower the cost he said

The premium increases have forced the formation of coalitions of business government and insurance companies that are looking for quick and inexpensive to settle disputes as options to court battles

LOCAL

Industry defends insurance rates

By MICHAEL S GORMLEY
Binghamton Bureau

Government bodies across the nation are reacting with panic to rising liability insurance premiums. And the high rates, which some municipalities and housing authorities can't afford to pay, aren't temporary, insurers say

"It is in a state of crisis," said John D Lake Sr, executive director of the Binghamton Housing Authority

The city of Binghamton has reacted with what officials hope is temporary self insurance after premiums rose more than 100 percent Broome County officials turned to self insurance when they felt reasonable premiums were turned down and they faced a 400 percent increase

Consumer advocate Ralph Nader has charged there may be collusion among insurance companies to increase insurance premiums

Is it a plot?

"Emphatically no," said Edward O'Hare, vice president of the Insurance Information Institute, a national advocacy group for the insurance industry

"I don't think there will be a decrease (in premiums) any time soon until the rates are up where they should be,' O'Hare said

Insurance rates aren't too high now, but are just where they should be, he said He said tremendous competition among insurance companies in the last several years and competitive bidding forced insurance companies to offer premiums that were less than necessary to cover the cost of the policy, resulting in a loss of $3 8 billion last year industry wide.

Also, more lawsuits against municipalities and larger awards made by courts when the municipalities lost lawsuits have forced insurance companies to demand higher premiums to cover the losses commonly experienced, he said

He also said court decisions have broadly redefined insurance policies, O'Hare said For example, long term or delayed payments have been awarded for pollution damages or injuries, he said Also, there is a belief that municipalities and insurance companies have "deep pockets" to pay steep punishments, O'Hare said

"Until there is some cap on lawsuits and the size of awards, municipalities will be very unattractive' O Hare said

Insurance firms blamed in BHA rate increases

By MICHAEL S GORMLEY
Binghamton Bureau

The Binghamton Housing Authority's annual insurance premiums probably will quadruple to more than $100,000 next year, board members learned yesterday

Edgar B Parsons Jr of Binghamton, the authority's insurance agent, blamed the jump in liability and property insurance on the insurance industry, sometimes calling its executives "jerks" and "idiots"

Parsons said the increase, probably to between $100,000 and $150,000 from $25,000 a year, is not caused by the BHA, which acts as public housing landlord for about 2,000 low income, elderly and disabled residents In fact, the authority pays less than $3,000 in claims yearly he said BHA authorities estimated the agency pays $1,000 or less

"The insurance industry is coming off the wall," Parsons said.

"As an agent, I don't think they're justified and show poor planning I think your organization is very well run one of the best-run organizations I've seen in the insurance field (but) you're trapped," he said

He said the Binghamton Housing Authority is facing cancellations or exhorbitant rates from the Aetna Life & Casualty Co of Hartford Conn because the government related entities have become — in general — poor risks He said the amount of liability lawsuits have increased within the classification so all policies within the classification are affected

To counter the rates the authority yesterday agreed to investigate other insurance companies the possibility of self insurance and to negotiate extensions with Aetna

The current policy expires Sept 1 and an extension — possibly the last — ends Sept 26 Parsons said

Insurance is paid with federal funds No local taxes will be affected authority officials said

Local section B

The Evening Press • Binghamton N Y Tuesday Aug 20 1985

Local

The Sun-Bulletin /Tuesday, August 20, 1985

3A

Housing authority insurance could quadruple

By MICHAEL S GORMLEY
Binghamton Bureau

The Binghamton Housing Authority may have to pay more than $100,000 in annual insurance premiums — a quadruple increase — to cover itself against less than $2,000 in claims, board members were told yesterday

Edgar B Parsons Jr. of Binghamton, the authority's insurance agent, said during the board's regular meeting that the authority's liability and property insurance probably will go from $[illegible] a year to between $100 000 and $150,000 a year, if an insurance company agrees to cover the authority

Parsons said the authority, the public housing landlord for poor, elderly and disabled people, pays out less than $3,000 in claims yearly That figure may be closer to $1,000 or less, authority staffers said

Parsons said the authority isn't to blame for the insurance increase He repeatedly praised the authority for its management and chastized the insurance industry, at times calling its executives "jerks" and "idiots"

Parsons and authority Executive Director John D Lake Sr said the situation is becoming an epidemic problem for municipalities and government authorities and agencies

The city of Binghamton and Broome County, along with municipalities throughout the Southern Tier and nation have set up their own funds for self insurance because insurance companies increased rates several hundred percent

"The insurance industry is coming off the wall," Parsons said

"As an agent, I don't think they're justified and show poor planning. I think your organization is very well run.. one of the best-run organizations I've seen in the insurance field (but) you're trapped," he said.

He said the Binghamton Housing Authority is facing cancellations or exorbitant rates from the Aetna Life & Casualty Co of Hartford, Conn., because the government-related entities have become — in general — poor risks He said the amount of liability lawsuits have increased within the classification, so all policies within the classification are affected.

To counter the rates, the authority yesterday agreed to investigate other insurance companies, the possibility of self insurance and to negotiate extensions with Aetna

The current policy expires Sept 1 and an extension ends Sept 16 Parsons said.

"You talk to the people (who run insurance companies) and you don't even think they're in the insurance business It's a damn shame I'm embarrassed to be part of an industry that's pulling this," he said

Parsons said the authority has had about eight claims against it in a year "To me, this is not frequency It's a stupid way I don't think it's a proper way, there's no logic to what they're doing," he said

Insurance costs, like most of the authority's expenses, are paid by federal funds No local taxes will be affected, authority officials said

Also, Alan P Zdimal was elected to chair the board, replacing Florence J Solak, who wasn't reappointed by Mayor Juanita M Crabb last month when her term expired F Daniel Casella was elected to fill Zdimal's vice chairman spot and the Rev Mark B Marino was elected to fill the secretary-treasurer post made vacant by Michael A Hiser's resignation from the board a month ago

Opinion

The Sun-Bulletin /Monday, August 19, 1985

6A

MICHAEL G. DOLL
Associate Managing Editor

Insurers take money and run

On June 18, Broome Community College President Donald W Beattie thumbtacked a memo addressed to the "campus community" on college bulletin boards It read

"I have been advised that our liquor liability insurance has been cancelled. Occidental Insurance Company, which was to have carried this coverage for us, is no longer underwriting liquor law liability coverage for student events At this point in time, there is no market for this coverage in New York State

"Consequently, until coverage is procured through an appropriate licensing underwriter, should coverage be made available in the future, Broome Community College will suspend the sale and/or disbursing of all alcohol at student events This includes all student activities, clubs, organizations and athletics "

So saith Occidental, one of the insurance industry's leaders in setting the nation's social policy Before we know it, Occidental and its ilk will have decided that there will be no doctors in hospitals, no swings in parks, no booze in bars and no baby-sitters at child care centers.

In short, the insurance industry — which stands shoulder to shoulder with the oil industry as the nation's richest — has decided to stop taking risks with the premiums it collects and focus instead on insuring only those activities in which the possibility of paying a claim is nil

This is the path to minting money, it is one the insurance industry has trod for many years amassing a fortune that is literally beyond belief

For decades, insurance companies have collected premiums from colleges, governments, hospitals, restaurants, and day care centers They have taken their customers' money and invested it on the theory that it will be on hand for a rainy day. In theory

In actuality, when it begins to rain the insurance industry gets out of the business Thus, it pockets all the rainy-day money it has collected and tells its long-time and faithful customers to go buy their own umbrella It's a neat trick

At least in part, the problem is sheer laziness, compounded by a good dose of greed Insurance companies no longer bother with the costly and time-consuming task of underwriting They insure almost anyone who can come up with the price of a premium, until the specter of actually paying a couple of claims arises

For example, physicians in New York state pay premiums that are based almost exclusively on actuarial averages for the various specialties Their insurer does almost no underwriting, which means coverage is given to physicians with small regard for their competence — or lack of it It's no wonder rates go through the roof or that insurance becomes unavailable

The same is true for governments, colleges, restaurants, and day care centers Let just one get hit for a large (and usually deserved) award, and all of a sudden the insurance industry grabs its money and runs It makes no difference that the rest of its customers are good citizens

It's high time the insurance industry started doing something for its money If it doesn't, everyone's going to have a hard time getting a drink — not just BCC students

SUNDAY PRESS August 11, 1985

Schools face rising cost of liability insurance

By HATTIE BERNSTEIN

This year in New York state insurance companies have denied liability insurance to doctors and municipalities. Now, the eye of the insurance storm is catching school districts, many of whom have seen their liability premiums for 1985-86 skyrocket.

In some cases, moreover, said a spokesman for Utica Mutual, New Harford, the insurance agent for almost half of the state's school districts, schools have been denied coverage outright.

Premiums this year rose astronomically for school districts across Broome and Tioga counties as well as New York state.

Tioga Central School District will pay $11,000 for liability insurance, up from its $1,100 premium for liability insurance for 1984-85. Its business agent, however, said, the increase won't affect school programs. Insurance costs represent 1 percent of the school budget for next year.

In Deposit, the school district will pick up a tab for $13,170 for liability, representing a 593 percent increase in liability insurance and 1.15 percent of the school budget.

In Vestal, liability will cost $57,700 or 589 percent more next year.

In Binghamton, the district will pay $23,000 for $5 million in liability compared with $6,575 for $10 million coverage it paid last year. This is 3.2 percent of the school budget and represents a 350 percent increase.

School business agents are hesitant to call the increases the beginning of a crisis. They say they are uncertain about the causes or duration of the increasing costs. But some are already considering contingency plans like self-insurance or mutual insurance.

A comparative idea would be the Medical Liability Mutual Insurance Company formed by doctors to deal with the medical malpractice crisis.

"Money paid to insurance certainly is not going into activities more closely related to instruction," said Leslie F. Distin, superintendent of Broome-Delaware-Tioga BOCES. The BOCES district, unlike many of its county counterparts, faces a relatively slight increase in liability insurance premiums for next year. But Distin said the district's multiple year contracts with Utica Mutual Insurance could be the reason for the lower rate.

"There's no use worrying about it now because I don't have all the facts yet," said Michael A. McMahon, school business executive for Maine-Endwell Central Schools. He said the district paid $24,000 for a $5 million liability umbrella in 1984-85, but could not give a figure for next year's coverage. "I have no idea," he said. "As far as whether I anticipate a crisis in the market, the only real way to determine if we have a problem is if we find out our carrier won't carry us.

Our board of education will be meeting with the local insurance agency very soon," said Charles E. Lawrence, business manager and school district clerk at the Whitney Point school district. "We're very concerned. We're a low wealth district ... we've never had a liability claim so we're trying to get a handle on exactly why such large rates are passed on to a school district such as ours."

Insurance experts said the increases are the result of market conditions — an insurance industry which for the past six years kept its liability premiums below market prices and recovered losses with investment income — and a judicial system quick to award damages in civil suits.

In some parts of New York state, school districts have already been denied liability insurance, effective July 1.

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Insurance

Continued from 1B

Utica Mutual, which insures 316 school districts in the state, will drop 81 of them July 1, Jack B. Riffle, chairman of the board, said in June at a national meeting.

Riffle also said the company had stopped writing school liability in Ohio in 1983, following an onslaught of claims after state courts had struck down a ruling which protected districts from expensive suits. When claims began to mount, the firm, said its chairman, offered to rewrite some schools at a rate three times the old rate. But another carrier bid for less and took the market.

In the Binghamton City School District, business superintendent Joseph B. Zapach, said his administration was prepared for the 350 percent increase in school liability. The district paid $96,000 in 1984-85 for all of its insurance and has an estimated bill for 1985-86 of $165,365. The latter figure represents 3.2 percent of the school budget for the coming year.

"When I was preparing the 85-86 budget," said Zapach, "I contacted the insurance agents and asked for projections." He said he received information from the State Association of School Boards — currently the association is conducting a statewide insurance survey among districts and plans to use the data to lobby the state legislature — and made budget projections based on these trends.

Increased insurance rates will not affect any school programs, Zapach said, adding that there will be no cuts. "We had planned for this," he said.

The Binghamton district has also studied ways to reduce accident risks and thereby stay out of court. Its insurance company conducts inspections on the school grounds, a policy known in the insurance industry as risk management. "With the financial problems the district is having, we're looking at ways to reduce costs. If we reduce exposure to accidents, it gives us a better experience rating," Zapach said.

Zapach's logic, however, may not follow current trends where premiums are apparently based less on experience ratings and more on market conditions and court decisions.

At Whitney Point, Lawrence said his district has never been sued. Yet its liability premium for 1985-86 is up 80 percent over last year.

In Johnson City, assistant business superintendent William A. Kingsley, said a number of suits against the district have gone to the United States Supreme Court over the last five years. One recent case was filed by a woman on behalf of her handicapped son. Previously, three similar lawsuits were filed against the district. Most other cases, he said, were settled out of court.

The district's general insurance for the 1985-86 school year is $166,000, up 74 percent. This includes liability.

According to state education law, said Richard J. Trautwein, senior attorney at the State Education Department, schools can be self-insured. No mandate requires the school district to purchase liability insurance. To protect the taxpayers, however, the purchase of property insurance is required.

If prices continue to rise, said BOCES' Distin, districts might establish insurance alternatives such as cooperatives where districts could pool their funds to provide insurance coverage. Another possibility, some said, is the mutual aid society concept similar to that established by beleaguered doctors during the malpractice crisis.

SUN BULLETIN August 9, 1985

Affordable rates for city insurance are still elusive

By MICHAEL S GORMLEY
Binghamton Bureau

The cost of liability insurance is an item to watch in the 1986 Binghamton city budget, according to a city statement

But city officials already have wrenched their necks watching insurance premiums more than double in a year

"We're still trying to buy insurance at a reasonable cost," said city Finance Director Donald E Freed

That, however, may not happen soon, he said

For 1984, the city paid $322,000 for insurance that included liability when sued and motor vehicle insurance For 1985, the lowest offer from insurance companies was about $8?7 000 for the same insurance, and that bid was rescinded by the insurance company shortly afterward, Freed said

For now, the city is paying for its own liability fund under a $495,000 short term self-insurance plan but it may be needed longer than wanted, he said

"I thought it would be quick, but we probably are looking at self insurance for two or three years but I'm guessing," he said

The city isn't alone

Among other examples of escalating insurance costs

- Broome County moved to self insurance in July when the cost of its liability coverage increased by about 400 percent to as much as $800 000
- In the Town of Oxford, town board members this month dropped a $1 million excess liability insurance policy and crossed their fingers that a major lawsuit isn't filed The town's insurance premium was increased by more than 12 times over last year, from $1,050 to $12,400 yearly for the small town
- In Sidney, the village board agreed to pay $31,000 more this fiscal year for liability insurance that costs twice as much as the previous year with half as much coverage

Muncipal and insurance officials nationwide point to the growing number of lawsuits brought against governments states *City & State*, a magazine of public business and finance Nationally, police negligence

FILE PHOTO

Donald E. Freed:
More delays than expected

and brutality cases trigger increases, and more insurance companies are leaving the municipal liability business because of large court-ordered awards against governments, the magazine stated

Freed said the cost of insuring against liability from pollution, toxic dumps and landfills also increases the costs Another cause is that municipalities often are forced to accept low bidders for insurance and companies don't want to provide a service all year just to be undercut the following year, the magazine stated

The result is that fewer insurance companies compete to provide lower premiums, the magazine stated

In Binghamton, Crabb's July 29 statement about the budget identified insurance as one of three items to watch

Freed said the city's self insurance kitty of $495,000 is based on the 1981 cost of $396,000 with reasonable yearly increases

The only alternative was to accept an insurance company's offer of $796,000 — an offer that wasn't rescinded by the company — but that carried with it a $250,000 deductible that the city would have to fund before the company paid

"We feel, based on past experience, that we're adequately covered," Freed said

USA TODAY August 7, 1985

Small businesses cringe as liability insurance rates soar

By John Reilly
USA TODAY

Liability insurance rates are skyrocketing as property/casualty companies try to halt steep losses.

The hardest-hit: the USA's small businesses, which lack the resources of large companies and industries to set up their own insurance funds.

Consider:

- A Michigan restaurant owner's liquor liability insurance premiums soared from $6,700 last year to $30,520 this year.
- A California day-care center operator's liability premiums more than tripled in one year to $31,000. By law she cannot pass the increase on to her low-income clients.
- Nearly 300 of the USA's 2,500 certified nurse-midwives have been notified their liability coverage will not be renewed; the number will reach 450 by the end of the month and 850 by year's end.

Last year the property/casualty industry lost $4 billion in operating income from premiums and investments. It was able to record an after-tax profit of $1.4 billion only by selling assets for capital gains, said David Oswald of the Insurance Information Institute.

Operating loss for this year is projected at $2.9 billion.

The industry blames what it calls excessive jury awards and broad interpretations by courts of what is covered under liability insurance.

"We've seen the courts hold people liable for things they were never held liable for before, and when the awards come in they've been much higher than they ever were," said Marc Rosenberg of the institute.

Hardest-hit are businesses in which claims may not arise until several years after an incident occurs. Recent allegations of day-care center abuse, for example, have made insurers shy because the law extends the statute of limitations until the victims have grown up and can sue on their own behalf, Rosenberg said.

Insurer Crum and Forster Inc. has stopped underwriting most pollution liability because courts have required insurers to pay for Environmental Protection Agency-ordered cleanups of sites where hazardous waste was dumped years earlier, Vice President Lee Cheek said.

By [illegible], USA TODAY

Walter Conti, owner of Cross Keys Inn in Doylestown, Pa., has seen his liquor liability premium triple in the past three years to nearly $16,000, the result of some large awards to victims of drunken-driving accidents who sued the bars that served the drivers.

The solution for some businesses may be to follow the lead of the medical profession and write their own insurance. The National Solid Waste Management Association is studying the possibility of setting up a self-insuring arm, executive director Gene Wingerter said.

■ Delta's liability, 3A

USA 850807

WALL STREET JOURNAL August 5, 1985

Small Firms Face Sharp Cost Hikes For Insurance—If They Can Get It

By David B. Hilder
Staff Reporter of The Wall Street Journal

Three weeks ago Heinz Popp was just a few days away from having to shut down his Porsche-Audi dealership in Brooklyn, N.Y. The insurance policy for the dealership was about to expire and two insurance brokers told him they couldn't find a company that would issue a new policy.

Finally, through a car dealers group, Mr. Popp found an insurance company willing to sell him a policy—but with a catch. Mr. Popp would have to pay whatever premium the company decided upon after it investigated his dealership. Desperate, Mr. Popp agreed.

"I needed insurance," Mr. Popp explains. "In the auto business, if you're without insurance, you're out of business."

Mr. Popp late last week was told his new policy will cost $119,000, or nearly three times the old premium of about $40,000, to insure about $2.3 million of new cars and auto-parts inventories against loss or damage.

Tenfold Increases

Across the country, businesses of all sizes are facing premium increases ranging from 25% to more than 1,000% for property and liability insurance—when they can get any coverage at all. And small businesses such as Mr. Popp's are being squeezed the hardest.

Bars, restaurants, liquor stores, day care centers and nursing homes—all experiencing or expecting increased claims—have been among the small concerns hardest hit by soaring insurance rates. Professionals, including midwives, doctors, accountants, architects and lawyers, also face skyrocketing insurance bills because of increasing malpractice suits.

Property casualty insurance rates historically follow a boom-or-bust cycle: three years of falling rates followed by three years of increases. But insurance brokers, executives and regulators say the current surge is the most pronounced in this century.

The reason is that commercial insurance rates plunged for six straight years as companies battled fiercely for business, hoping to invest the premiums at high interest rates before claims had to be paid. But premiums were driven too low, the industry had a $3.8 billion pretax operating loss last year, and now insurers are trying to compensate by raising prices and getting out of types of business that have resulted in big claims.

"There's still a yawning gap between industry premiums and underlying loss costs," says David Ostwald, vice president of Insurance Services Office, a trade group that collects data from the nation's insurers and suggests rates. "For the past six years, insurance buyers have been the beneficiaries of policies that have been priced at bargain levels. Now the white sale's coming to a close."

Businesses that can raise prices will pass some or all of the higher premiums along to customers. But some businesses can't do that and are seeing their earnings eaten away by higher insurance costs. "In many cases, it's going to wipe out their annual profit," says Lawrence J. Bulwin, a Great Neck, N.Y., insurance broker. He cites a New York sprinkler contractor who paid $11,000 last year for a $10 million liability policy but this year is paying $125,000 for a $5 million policy.

The conventional ways of controlling premiums aren't always available to small businesses. Many can't afford to absorb casualty losses by taking higher deductibles. Solutions being adopted by larger companies, such as setting up their own insurance subsidiaries or forming group-insurance organizations, usually are too expensive or cumbersome. And many small businesses, unlike big industrial companies, weren't warned last year by their insurance agents or brokers about the size of premium increases in store this year.

Hard-to-Get Insurance

The following types of insurance are the most difficult to buy:

1. Pollution risks
2. Liquor liability
3. Day-care center coverage
4. Medical malpractice
5. High-limit coverage (above $50 million) for industrial firms
6. Asbestos removal from schools
7. Commercial fishing boat coverage
8. Municipal liability

Source: Insurance Information Institute

"It was really a shock to us," says Timothy L. Cross, president of Surgical Specialties Instrument Co., a Crofton, Md., wholesaler of surgical implants and instruments. Mr. Cross says he budgeted for a 10% to 15% premium increase from last year's $4,722 for $1 million of product liability coverage.

But the first two quotes he received were for $120,000 and $70,000 for similar coverage. Finally, his insurer, Fireman's Fund, renewed the policy for $30,071.

"We're glad just to have coverage," Mr. Cross says. "We went down to the last day not knowing what was going to happen." Still, he says, the higher premium "really cuts the profits. Most of our prices are dictated by the manufacturers."

The insurance market's sharp turn has created other seemingly absurd year-to-year comparisons. Last year, Garland Flaherty, a restaurant owner in Louisville, Ky., paid a $50 premium for $300,000 of liquor liability insurance, which protects against lawsuits stemming from accidents involving patrons who had been drinking.

When the policy expired May 1, Mr. Flaherty was confronted with a $1 million policy for a $10,000 premium. "A jump from $50 to $10,000 is rough on any business," he says. By June, he found another company willing to write a similar policy for $3,826—still a 7,552% rise for a 233% increase in the amount of coverage.

Some insurers are demanding a percentage of a company's revenue. One Connecticut crane operator is paying $18,000 a year plus 10% of his gross revenue over $175,000 for $500,000 of liability insurance. Last year, the crane operator paid $5,000 for $1 million of coverage.

By choice or necessity, many small businesses are buying less coverage, particularly liability coverage, which pays the cost of defending or settling lawsuits. This, in turn, leaves them vulnerable to a big lawsuit or jury award. And it ultimately could hurt those who have claims against the businesses by reducing the amount they can collect.

Joe Fiore, a South Windsor, Conn., insurance agent, cites an auto parts wholesaler for whom he could find only $19 million of fire-insurance coverage to replace a $33 million policy that expired May 31. The new premium was $155,000 compared with $60,000 the year before, but Mr. Fiore says the reduced coverage was of more serious concern.

Richard Merrill, a San Francisco insurance broker with the firm of Rollins Burdick Hunter, says two clients will drop earthquake insurance rather than pay annual premiums up to $750,000 for $30 million of coverage. Last year, Mr. Merrill says, his clients had up to $100 million of coverage for premiums one-tenth as much.

Because of Surgical Specialties' premium increase, Mr. Cross says the firm couldn't afford to buy an additional policy covering losses caused by interruptions to supplies from manufacturers. "If we cut back (on coverage) anymore, we'd really be exposing ourselves to some financial losses," he says. "We just don't want to take that chance."

The Regulators' Role

Business owners are beginning to turn to insurance regulators for help in finding coverage. Regulators can enforce laws against policy cancellations in some states, and some are circulating lists of companies willing to issue policies. But usually regulators can't force companies to write business they don't want, nor can they generally restrict premium increases.

"We're here to ask questions and make sure the reaction (to insurance-company losses) isn't excessive," says New York Insurance Superintendent James P. Corcoran, whose office is surveying businesses to determine the extent of the insurance shortage.

The tightening insurance market has already prompted at least one legislative remedy opposed by insurers. In Massachusetts, where liquor liability insurance dried up after several court decisions upheld the liability of liquor stores and restaurants in patrons' auto accidents, the state enacted a bill forcing insurers to write liquor liability coverage if they want to do business in the state. The rates will be subject to state regulation.

EVENING PRESS July 17, 1985

FILE

Vestal faces rise in liability costs

By MARY BETH COLACECCHI
Western Broome Bureau

The Vestal school district board of education last night declined to reduce its excess liability insurance coverage for next year to $5 million from the current $10 million despite a large increase in premiums.

The renewal notice for the district's excess liability insurance set next year's premium at $44,200 for $5 million worth of coverage, the district's insurance consultant, Gilbert Chubb, of Barrett and Chubb Inc., 625 Vestal Parkway, Vestal, told the board at a work session following the board's regular meeting last night.

At the regular meeting the board decided to hire former Union-Endicott school superintendent William A Zimmerman to act as interim superintendent to replace John J Keough, who has resigned

Chubb told the board Vestal's current excess liability insurance premium is $9,800 for $10 million of coverage The district also has $1 million in basic liability coverage, he said

"In my opinion, if I were on the board of education, I'd have quite a problem with the numbers we're talking tonight, bearing in mind that with the premium for $5 million worth of coverage, we're already $24,800 over budget," he told the board.

School districts in general have the biggest potential exposure to lawsuits in their school buses, Chubb said. Vestal's largest buses can transport up to 66 children. In the case of an accident, 66 sets of parents could sue — and then even $20 million worth of coverage might not stretch far, he said

Zimmerman said he will take a few weeks off before getting back to the business of running schools, however temporarily

Zimmerman, 60, who retired from the Union-Endicott post in June, was approved for the Vestal position by a 7 to 0 board vote without discussion. Keough is resigning as of Aug 7 to take a similar post with a Long Island school district.

Zimmerman is to serve as superintendent until a permanent replacement is found Board members have estimated the search will take about six months.

His salary for the position hasn't been determined, he said. Interim superintendents are generally paid a per-day fee plus expenses A recent article in the *New York State School Boards Association Journal* indicated average base fees paid to interim superintendents in the state ranged from $100 to $300 per day.

The board last night accepted Keough's formal notice of resignation.

The board appointed Robert F. Savitt of Guideline Consultants Inc., Great Neck, as a consultant to assist in the hiring of a new permanent superintendent, for a fee of $6,500 plus expenses. Pa[illegible] S Griffiths, board member, cast the sole vote against the contract, without discussion He later declined comment on his reasons.

On another matter, board member Patricia H Charlton cast the sole vote against a proposal to sign a contract with Geal Engineering, P C, of 1 Endicott Ave., Johnson City for $825 worth of work to supervise the demolition of the district's old Main Street School, or Red Brick Building

SUNDAY PRESS July 14, 1985

Insurance woes hit day care

By GEORGE BASLER

Shortly before Mary Ellen Pattee was to renew the insurance for her Endicott based pre school program last May, she found it was being cancelled

The insurance agent called her with the bad news The company that had been insuring the program was no longer writing policies for preschools or day-care centers

When I got the news, I was appalled," said Pattee, who directs the Bonner Community Center, 201 N McKinley Ave , Endicott.

"It just hit out of the blue We have absolutely no black marks on our record

The Bonner Community Center was able to find insurance with another company, but its annual premium went up nearly 500 percent — to more than $2,000 a year from $400 a year, Pattee said

The Bonner Community Center isn't alone in facing this problem Struggling with financial troubles and worried about highly publicized child abuse cases, some of the nation's largest insurance companies have stopped writing child-care policies Others have substantially increased their premiums

"We've had price increases reported from a low of 43 percent to a high of 470 percent," said John McCann, regional vice president of the Insurance Information Institute in San Francisco

This is bad news for day-care centers across the country

A national survey last spring by the Child Care Action Committee found that two-thirds of the 250 day-care centers responding had lost liability insurance or paid large rate increases.

The problem is even worse for family day-care homes that handle a few youngsters at a time and have less leeway in their budgets to absorb rate increases said Carolyn Strnad deputy director of the action committee

Local officials worry about the long term effects of insurance problems They are concerned that the problems may drive some child care programs out of business or force them to increase their rates to the point that working parents, who need the service, will no longer be able to afford it

"A natural outgrowth (of increased insurance rates) is that the cost of day care and child care will increase " Emilie Kudela, director of the Broome County Child Development Council

"People who need the service are going to be forced to come up with the money or forced to go to look to the black market (unlicensed, underground day care homes)," said J Scott O'Neil,

See INSURANCE, 4A

Mary Ellen Pattee
. *in trouble*

Continued from 1A

owner of Wee Care Day Center, 607 Main St , Johnson City

Officials note there is already a shortage of adequate day care in Broome and surrounding counties Only seven licensed day care centers are open in Broome, one is open in Tioga County, and none are open in Chenango County.

In Broome County, 3,200 children need some kind of day care, but only 319 slots exist in child-care centers, officials said.

A sampling of some local child-care programs illustrates the extent of the insurance problem:

• The Wee Care Day Center saw its liability insurance premium increase to $300 a month from $200 a month. Its insurer, Travelers Insurance Companies, has already said it will discontinue the policy next year.

• The Endicott Day Nursery, 1706 Monroe St , Endicott, had its policy discontinued after 20 years with the same company Fortunately, the center found other insurance, with only a nominal increase in rates, said Director Nanda Cook

• The Day Nursery Association, 32 Stuyvesant St and 320 Clinton St , Binghamton, is anticipating as much as a 100 percent increase in its liability insurance costs, said Director Timothy Stephenson.

• Kid Korral, 435 Robinson St , Binghamton, has been told by its agent to expect a 25 to 30 percent increase in its premium rates, said Director Sandra R Schoonmaker.

Schoonmaker said the center is protected, to some extent, from the insurance crisis because it is part of Empire State Day Care Services Inc , a network of 22 day-care centers that enrolls only children of state employees.

The center was able to get insurance through a pool with other centers that are part of the Empire State system, she said

But, she said, for some independent centers the prob...m is insurmountable because companies cancelled their policies, or boosted their rates beyond the centers ability to pay

"A lot of centers are going from hand to mouth It's not a lucrative business There's no way they can absorb a 200 to 300 percent increase," Schoonmaker said

Some day-care officials place the blame for insurance problems squarely on insurance companies They argue companies are unnecessarily running scared over reports of child abuse and molestation in day care centers and boosting their rates accordingly "Insurance companies admit they haven't done any valid actuarial studies They're just reacting to public hysteria," said Stephenson of the Day Nursery Association.

Stephenson said he knows of no huge payments by companies in cases of alleged abuse in day-care centers In fact, he said, less than 2 percent of all child abuse cases occur in day-care centers, according to a report by the Child Defense Fund

Insurance industry officials tell a different story

McCann of the Insurance Information Institution said day-care centers have traditionally had low premiums and have never been a very profitable business for insurance companies

"We have underpriced them for years," he said When you add in child abuse and child molestation cases, the risk is raised out of sight, he said

"Every major city in the country has its own sensational child abuse case," he said

Kevin Foley, director of public information for the New York state Insurance Department, said the insurance problem faced by day care is the result of several trends meeting at the same time

First, the U.S. insurance companies are suffering through financial problems, partly because of falling investment income, and partly from large claim payments, he said.

Faced with financial troubles — the industry lost an estimated $4 billion in 1984 — insurance companies are shying away from insuring child-care programs because of highly publicized cases of physical and sexual abuse, he said

The industry is afraid that litigation from these cases will result in large judgments, he said

"They (insurance companies) don't know how to price policies for this type of coverage They fear the court system and open-ended liability," Foley said.

Some companies that are still writing day-care liability policies are setting stricter qualifications.

For example, St. Paul Fire and Marine Insurance Co , which says it lost $4 million last year on day-care insurance, is writing restricted policies that exclude coverage for physical and sexual abuse.

Foley said insurance is sometimes taken for granted, but people must realize it's a business If a company cannot make money selling a certain product, it is not going to sell it, he said, and "That's unfortunately the case with day care of the present time "Such words are little solace to child-care programs that are experiencing problems

Pattee said Bonner Community Center has never had a claim for abuse or neglect filed against it In fact, parents work with the staff to care for youngsters.

"In our case this is ridiculous," she said She said the center is living off its bank balance this year to keep operating without raising rates She doesn't know what will happen next year if the center is hit with another boost in insurance costs.

"For a small, non-profit organization, this is a real killer," she said.

O'Neil of Wee Care Day Center said the solution to the problem rests with the state insurance department

He said the department should require all insurance companies who want to do business in the state to provide liability coverage to day care centers at a reasonable rate

But Foley said there is no short-term solution "There's nothing we (the state insurance department) can do, under insurance law, to make prices lower, ' he said

McCann said child care programs are going to have to be run better and will have to introduce risk management procedures to bring down their insurance costs

"Insurance companies aren't the problem and they aren't the solution he said

SUNDAY PRESS July 14, 1985

Banks and businesses are hard hit by rising liability insurance costs

Los Angeles Times

San Francisco based Bank of America in a nervy move earlier this year that infuriated the insurance industry, sued six of its own officials and tried to collect on insurance policies covering officers against shareholder and customer lawsuits

The fallout was immediate The bank's liability coverage was canceled Spurred by the insurance industry, Bank of America was forced to create its own insurance subsidiary for one client — itself And the move added to the difficulties that banks nationwide are having finding affordable directors and officers liability insurance

Banks aren't the only businesses having trouble obtaining coverage to protect their executives against lawsuits the days Unocal is suing four insurance companies that canceled its directors and officers liability policies the day that T Boone Pickens Jr disclosed his takeover attempt And executives of chemical firms and utilities who face potential huge future claims from worker deaths or toxic spills or nuclear accidents are virtually uninsurable

Higher insurance premiums will eventually be passed on the public, as will the cost of increased reserves that businesses will be forced to set aside to pay uninsured claims

Banks will adopt more conservative lending policies and other fi[...] will take fewer risks that could pose them to lawsuits Bigger lo[...] by insurance companies means [...]ger premiums for all policyholde[...]

In addition companies will [...] more difficulty recruiting top-[...] outside directors who will fear [...]ting their personal fortunes in j[...]ardy because of decisions take[...] the firm

"This has b[...]ome a zoo The tactics are quite appalling," said [Da]vid Simmons of the Insurance I[...]mation Institute "What I see as [...]ou[t]come of this is the reluctanc[...] write D&O (directors and offi[...] liability insurance) on the par[...] anybody by underwriters, who [...] losing money by the ton as it is"

The crisis in directors and offi[...] insurance — also known as [...] porate malpractice coverag[...] grows from a number of factors [...]verging at once

The insurance industry suff[...] losses last year in excess of $3 [...]lion and is dropping unprofit[...] lines Shareholders, customers [...] regulators are quicker to su[...] ever before

Bank failures and takeover b[...] have led to hundreds of costly suits against corporate man[...] and board members And court[...] increasingly liberal in interpr[...] corporate and individual liabilit[...]

Banks are among the hardest [...]ankers and insurers say, bec[...] their losses come so often an[...] such massive doses

Bank of America, for instanc[...] seeking to recover $95 million lo[...] an alleged mortgage fraud tha[...] bank blames on negligent em[...]ees

Chase Manhattan is suing su[...] mer workers in an effort to rec[...] $175 million in losses stemming [...] the Penn Square Bank failure

Ohio bank regulators have [...] the former officers and directo[...] the closed Home State Savings [...] for $372 million The Federal De[...] all U S banks, wants to rec[...] more than $1 billion lost in the [...]nental Illinois debacle

The so-called "offensive" [...] liability policies, most dramati[...] seen in the Bank of America [...] Chase cases, originated in 1978 [...] tiny Bank of Warren County in [...] Munnville, Tenn

The bank, after suffering sub[...]tial loan losses, sued its own boa[...] directors for mismanagement [...] filed a claim with the bank's ins[...]

"The D&O carrier screamed [...] that's not what was intended [...] policy But there wasn't anythi[...] the policy that prevented this ty[...] action," said attorney Pat Ar[...] Memphis, who represented the [...] "We settled the case quietly [...] was just a country bank and [...] have the impact of a [...] Chase"

In fact, the market barely noticed Demand for D&O policies was growing, so much so that today, an estimated 98 percent of New York Stock Exchange listed companies carry some sort of executive malpractice coverage Competition drove rates down and coverage limits up, in some cases as high as $200 million

Then, last year, the hammer fell Pay-outs on D&O policies, particularly at banks and other financial [institutio]ns, amounted to three times [...] from premium Insurers be[gan] abandoning D&O for banks, or getting out of the D&O business entirely

"Look at what's going on around you in financial institutions Look at the number of them in distress Look at the amount of litigation," said Joseph P DeAlessandro, president of National Union Fire Insurance Co of Pittsburgh, the nation's largest writer of D&O policies "The easy way out is to say we won't write that line"

DeAlessandro said, however, that his company would continue to insure banks, although some troubled institutions have been dropped

A wave of bank failures in the last two years touched off dozens of suits by shareholders and prompted the FDIC to seek recovery from former officers and directors of failed banks — and their insurers — a tactic that regulators said was not new

"We've been doing this for years What's changed is that more banks are failing and bigger banks are failing," said Mark Rosen, assistant general counsel at the FDIC

He said the agency currently has 60 D&O claims pending and is contemplating filing another 150 All, except the $1-billion action against Continental Illinois, involve closed banks and were brought by the FDIC as receiver or liquidator

Some banks, such as Bank of America have been canceled in the middle of their policy terms Others are seeing premiums rise from [...] percent at the healthiest companies to 1,000 percent at larger or more vulnerable institutions, according to Brockmeier

At the same time, coverage limits are shrinking to $30 million or less from $50 million or $100 million and deductibles are rising to $10 million from $2 million As limits fall and deductibles rise the policies begin to look very much like self insurance

WALL STREET JOURNAL July 10, 1985

Risky Business: Companies Are Finding It Difficult Now to Obtain Liability Insurance for Their Directors

Continued From First Page

ket or have sharply restricted underwriting. John R. Foley, a senior manager with Chicago-based CNA Insurance Cos., estimates that the industry's capacity to handle about $100 million on a year of D&O premiums, about one-sixth of the market, has disappeared.

Before this year, D&O premiums for large companies were often less than $100,000 for as much as $100 million of coverage. Now many companies are having trouble buying more than $50 million of coverage and premiums of more than $1 million are common, brokers say. For example, Allied Corp., the big chemical and electronics concern, paid $85,000 for D&O insurance last year. This year, according to its proxy statement, Allied is paying $347,000. The amount of coverage wasn't disclosed in either year.

Further Constriction

"The state of the market is extremely difficult," says Joseph P. DeAlessandro, the president of National Union Fire Insurance Co., an American International Group Inc. unit and one of the largest remaining D&O underwriters. "It is eminently clear that the D&O market is going to constrict even further before our eyes."

Among those that have withdrawn from the business are Verna's former insurer, Midland Insurance Co., a unit of Katy Industries Inc., and Home Insurance Co., a unit of City Investing Co. Hartford Insurance Group, a unit of ITT Corp., and Crum & Forster, a unit of Xerox Corp., say that they are being more selective in deciding whom to cover.

In response to the tightening market, Marsh & McLennan Inc., the world's largest insurance broker, has said D&O policies will be offered by a new insurer that it is organizing to provide liability coverage for large companies. The new insurer, which will be owned by its policyholders, is to offer $50 million of D&O coverage to each corporate policyholder. The coverage, however, will pay only the amount of claims in excess of $50 million. On a $75 million loss, for example, it would pay $25 million.

Banks and thrifts currently are having an especially tough time finding D&O insurance, brokers and underwriters say. That's because of an increase in suits against directors by federal regulators as well as two highly publicized suits by banks against former officers and 79 bank failures last year, a post-Depression record.

Shunning Banks

"Financial institutions, banks in particular, are considered persona non grata at most insurance companies," says Albert Salvatico, a managing director in charge of D&O coverage at Marsh & McLennan. Chubb Corp. and Continental Corp., two major insurers, say that they have stopped writing new D&O policies for banks and thrifts.

Another problem for insurers is that the Federal Deposit Insurance Corp. and the Federal Savings and Loan Insurance Corp. are routinely filing suits against the directors and officers of failed banks and thrifts, hoping to collect on D&O policies.

That has caused many insurers to rewrite D&O policies to exclude claims stemming from lawsuits by regulatory agencies. "No private insurance company wants to fund the federal government," says Mr. Foley of CNA. "We feel that's basically a risk that can't be underwritten."

Two major banks have stunned insurers by suing their own employees under D&O policies. Chase Manhattan Bank has sued six former officers for $175 million, alleging negligence in buying loans from Penn Square Bank. And Bank of America has sued one current and six former employees for their alleged role in a mortgage-backed securities scandal that cost the bank $95 million.

Canceled Policy

Bank of America's D&O insurance was canceled shortly after the lawsuit was filed. The lawsuit "clearly was contrary to the spirit and intent behind the policy," said Anthony Lanzone, a lawyer for one of the insurers, Wisconsin-based Employers Insurance of Wausau.

Other insurers agree. And several, including National Union Fire, Crum & Forster and CNA, have changed policy language to make that point. The new language says that an insurer won't cover claims resulting from a suit by a covered person or company against another covered by the same policy.

To restore its insurance coverage, Bank of America set up its own insurance subsidiary in the Cayman Islands. Another San Francisco-based company, Pacific Gas & Electric Co., also set up its own insurer after part of its D&O coverage was canceled.

By establishing its own insurance unit,

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known as a "captive," a company in effect pays insurance premiums to itself. The advantage is that premiums are tax-deductible as a business expense, while money simply set aside in case of an eventual claim isn't.

Other factors making the D&O market difficult, insurers say, have been the increasing number of hostile takeover fights, which often spawn shareholder suits, and a Delaware court ruling that appears to tighten the standard for deciding whether directors have used "informed business judgment" in accepting or rejecting a merger bid.

Unocal's Vulnerability

On the takeover front, last Feb. 15, the day after a group led by T. Boone Pickens Jr., the chairman of Mesa Petroleum Co., said it had acquired a 7.9% stake in Unocal Corp., Unocal was notified that its primary D&O policy, issued by a unit of Continental Corp., would be canceled. Several other insurers quickly followed suit. The insurers apparently feared that the Unocal board might be sued by holders if it rejected any Mesa offer.

To replace its $100 million total coverage, Unocal had to pay $6.6 million in premiums plus $13 million as a reserve against possible claims. Unocal hasn't disclosed the total premium it had paid for its original $100 million in coverage, but it has said that $70 million in coverage had cost $140,145.

Unocal also bought a $50 million D&O policy from National Union Fire, but it agreed to reimburse the insurer dollar for dollar for any claim it paid.

Unocal has filed a suit against the insurers, charging that the policies were canceled to avoid claims that might arise from its fight against Mr. Pickens. Continental has declined to comment on the charge. Unocal eventually made peace with the Pickens group and no holder lawsuits have been filed.

The Delaware court ruling, in a suit against the former board of Trans Union Corp., held that directors acted too quickly in approving a $55-a-share bid from a company controlled by the Pritzker family of Chicago. A lower court must decide whether the offer was fair.

Finally, Union Carbide Corp., which faces myriad problems occasioned by the December gas leak at its Bhopal, India, plant that killed about 2,000 people, also lost its D&O coverage as a result of the catastrophe. Carbide says the coverage, for which it paid $83,167, has been replaced, but the company declines to disclose the coverage it has now.

There isn't any doubt, however, that Union Carbide was looking for coverage at a bad time in the D&O market. "There is a great deal of hecticness and concern on the part of the broker and the client and the insurer," says Mr. DeAlessandro of National Union Fire. "It's going to be a long time before the market rights itself."

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Risky Business

Liability Insurance Is Difficult to Find Now For Directors, Officers

Suits by Shareholders Cause Premiums to Skyrocket, Insurers Cancel Policies

Flight From the Board Room

By DAVID B. HILDER
Staff Reporter of THE WALL STREET JOURNAL

When Verna Corp., a Houston-based oil and gas drilling company, lost its $2 million directors' and officers' insurance coverage last month, four of its five outside directors quit.

"It's just a matter of self-interest," says W. Grogan Lord, a Verna director who resigned rather than serve without the insurance, which protects against lawsuits by disgruntled shareholders.

"I just can't afford to expose my personal assets to the risk," says the 70-year-old Mr. Lord, a wealthy Houston businessman. "The legal profession is sinking out [illegible] place it can find a pocket. And I [illegible] happen to have a pocket."

As recently as last year, directors' and officers' liability insurance, known as D&O coverage, was relatively cheap and plentiful. But as the companies that pay the premiums are finding, it has become expensive and scarce. And that has sparked fears that many companies will lose outside directors and find it hard to replace them.

L[illegible] for More

Premiums for D&O coverage are anywhere from three to 10 times higher than they were last year, insurance brokers say. And in almost all cases, the higher [illegible] are buying less coverage.

Premiums are rising because insurers have suffered heavy losses on D&O policies and [illegible] even bigger losses ahead. As a result, insurers are pulling out of the D&O business, reducing the supply of coverage as demand is increasing.

Particularly hard hit have been bank[illegible] oil and gas, and computer industries. [illegible] number of companies in these industries have failed, thus triggering lawsuits against directors.

Insurers also are shying away from companies involved in takeover fights and from chemical and drug concerns vulnerable to big pollution or product-liability claims.

Declining Coverage

Meanwhile, the handful of insurers that still write D&O coverage are taking advantage of the sellers' market by changing policies to eliminate certain types of claims.

Some companies, unable to buy all or part of the coverage they want, have set up their own insurance subsidiaries. And insurance experts predict that more and more companies will find themselves, like Verna, bereft of coverage.

That leads some directors to warn that the insurance shortage could lead to an exodus of outside directors, who are supposed to keep tabs on management. "If directors go bare [illegible]," says Walter B. Wriston, the former chairman of Citicorp and currently a director of nine companies, "you're going to reverse the process of getting more and more outside directors and less and less inside directors. I don't know of anybody who would join a board without D&O insurance."

But others argue that the tighter market could improve the quality of corporate boards. "I think you're going to see an era when people don't sit on four or five boards," says John Whiteside, an insurance broker in New York with Alexander & Alexander Services Inc. "They may sit on one or two boards and really pay attention to what's going on."

A Losing Gamble

The current market for D&O coverage, which Mr. Whiteside says is "in total disarray," is partly the result of forces that have driven up prices of other kinds of business insurance since late last year. Rates for commercial policies had been falling for six years. Insurers weren't charging enough to cover claims, but they expected to make up the difference by investing premium dollars until claims were paid.

That worked for a while, but rising claims and falling interest rates made the gambit a loser. By late last year, as the property-casualty industry was about to post a record $3.8 billion operating loss, prices began to rise.

D&O premiums have been rising much faster than rates for other kinds of liability policies, insurance executives say, because of rising claim payments on D&O policies and the relatively low premiums paid in recent years. Based on rates in effect early last year, Wyatt Co., an insurance consulting firm, estimates that insurers were paying out three to four times as much in claims as they received in premiums.

And several big losses—already paid or anticipated—have sent a shudder through the underwriting business. Last year, insurers paid what is believed to be the largest D&O claim ever, about $25 million, to settle shareholder lawsuits alleging mismanagement by former directors and officers of Wickes Cos., a Los Angeles retailer that emerged this year from reorganization under Chapter 11 of the U.S. Bankruptcy Code.

Still awaiting resolution are similar lawsuits stemming from troubles at Continental Illinois National Bank & Trust Co. of Chicago, Seattle-First National Bank and the failed Penn Square Bank.

With such problems in mind, several insurers have withdrawn from the D&O mar-

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FILE

Broome can't get liability coverage, may create its own

By GAIL ROBERTS
Binghamton Bureau

Broome County will lose its liability insurance July 1 because of skyrocketing premiums and the reluctance of carriers to insure municipalities, Fred R. Haacker, the county's risk and insurance manager, said yesterday.

To offset the loss in coverage, the county is considering establishing a self-insurance fund of $300,000 to pay claims and lawyers' fees, Haacker said.

Haacker, who spoke during the legislature's finance committee meeting, said he could find no insurance company willing to insure the county for general liability.

"We can't find general liability insurance," Haacker said. "There is no coverage for us at this point."

Late last week, Haacker said the county might find liability coverage if it were willing to pay $1 million in premiums, about a 400 percent increase from this year's premium of $202,000. With that increase, the county also would have been expected to pay up to a $250,000 deductible.

However, even that option is no longer available because insurance companies consider insuring municipalities a bad risk, Haacker said. The problem is statewide.

In Broome County, about 100 liability insurance claims are filed each year, Haacker said. The actual payout in awards and lawyers fees is about $200,000, with other incurred fees bringing the total yearly loss to about $300,000, he said.

County officials said they will meet soon to discuss a self-insurance program and any alternatives.

"I feel extremely — not nervous — I guess I'm hoping we can generate some enthusiasm to control our claims. I'm concerned about frivolous claims," Haacker said.

"I guess I'm almost numb to it at this point. We're concerned. We're going to continue to watch the market," he said.

The county will be able to get coverage for other types of insurance, such as property, aviation, and hospital malpractice insurance.

Mr. FLORIO. I express my appreciation to the entire panel.

Might I ask the two representatives of nursing interests, what has been the rationale that has been put forward by the insurance companies in denying coverage if, in fact, the information you provided to us is correct, that the good loss experience in the area of midwifery is particularly to be contrasted with the experience in dealing with obstetricians?

There is certainly not a loss situation. What has been the statement that has come back to justify the unavailability of insurance?

Ms. McHUGH. The main statement is that we have had primary carriers who were very interested who could not find any reinsurance, and since we do feel that it is necessary to have million dollar coverage, that has been the major stumbling block.

Mr. FLORIO. My question is: What is the rationale that has filtered back? We are going to hear from a reinsurance person today, but has any representation been made to you as to why reinsurance was not available to the primary carriers?

Ms. McHUGH. One of the problems that seems to be a subtheme to all of this is that of predicted risk rather than looking at our claims record. People frequently equate the practice of nurse-midwifery with the practice of obstetrics. I think that is a crucial distinction that people that remember that in order to remain certified, a nurse-midwife deals with the healthy mother and has a clear-cut referral system for the mother who has medical complications.

We do not do surgery, forceps, or breach deliveries, or many of the high-risk situations.

Mr. FLORIO. You are just saying it's just lack of knowledge.

Ms. McHUGH. We feel that is a great part of it.

Mr. FLORIO. That is ironic because one would think with a record between the two professions, the interest, having an interest in maximizing its rate of return would almost seek out a practitioner who is going to be less of a problem in terms of claims paid out, and that one would hope that there is sufficient interest in finding out the facts so as to be able to carry out one's own self-interest, which in this case, if the representations are correct, it is in the self interest of the insurance company to seek out and provide coverage to those that they would be inclined to pay less out in terms of claims.

Ms. McHUGH. One would hope that, Mr. Chairman. It doesn't seem to have been what has happened. And I am sure you are aware of the panic within the insurance industry when the word "obstetrics" is mentioned because of the long statute of limitations.

Mr. FLORIO. Let me ask our public officials, representatives from public agencies. When I was associated with local government in the local city attorney's office a while back, we had a trauma with workmen's compensation insurance. The insurance companies would not come forward. The municipality decided to become the self-insurer, and it worked fairly well.

On the basis of astounding facts that Baltimore has presented to us, what is it that would prohibit the city of Baltimore or any public authority from operating, assuming they had minimal investment to get some qualified, competent people to run it, to take the one-half million dollars' worth of premiums over the last

number of years, put them into investments—or rather the 6 million dollars' worth of premiums, and pay out the one-half million dollars' worth of claims and, in a sense, run it itself in a way that would give you the same return the insurance company has gotten?

Mr. PRESSMAN. Mr. Chairman, the city of Baltimore did go that way in regard to liability insurance. We now have a fund which is administered by the law department, and we have found that that fund has grown as a result of our having made contributions during the budget process each year and having reached a point where we made out a lot better than the insurance companies claimed that they did.

That is in regard to a remark made by Mr. Nader and others here today that the insurance companies set aside a reserve and they don't spend that much. They put that aside, and they are permitted to show on their books that they lost money when they make money.

I would like the insurance companies to answer that because that is something that ought to be addressed by the insurance companies.

Mr. FLORIO. Why wouldn't the insurance companies' response be, if you are correct and Mr. Nader is correct: You do it. You go and utilize the moneys. You follow the same practices. They maintain you are understating risks, you maintain they are overstating risks. Isn't the answer as to who is correct whether you can duplicate this? And if the insurance companies and the position of the industry is incorrect, what will happen is you will be able to take away their market. Ultimately they will find themselves out of what you maintain is a lucrative field.

Mr. PRESSMAN. The insurance companies show losses, as I stated before, by having reserves which are unrealistic. They are above the amount that are required for reserves. They never pay these moneys out.

Now, the city of Baltimore has resorted to self-insurance in regard to automobile liability and in regard to other liability, and we are satisfied with what has happened as a result of that. However, we feel that we should know when we make a budget up that we are going to have a certain amount of money to appropriate in each department. We want to be certain about what the tax rate is, and we are required by law to provide a certain given, fixed-tax rate, and we need to do that in order to be able to comply with the requirements under the city charter.

So we have gone as far as we should go in regard to having self-insurance, but we decry the fact that the insurance companies have not furnished the necessary information that would be necessary in order to check them out to see if they are really losing the money that they claim they are losing, and we don't think we should go without having proper coverage.

Now, you take the city of Sykesville that I mentioned before. Those members of the administration that were elected officials just resigned rather than to assume that responsibility.

Mr. FLORIO. Those numbers that you put forward are very startling, very impressive. You have $6 million in premiums coming in to the insurance company, $500,000 going out in claims. Do you have any idea how much of a reserve was set aside by the insur-

ance company so that we could get some sense of the rate of return to the insurance company?

Mr. PRESSMAN. We do know they received over $6 million in premiums; we do know that they paid $506,000 in losses. And there really is no need for us to know what their reserves are.

Mr. FLORIO. There is if you follow the insurance companies' approach, saying that if they were required to put $4 million aside in reserves, they couldn't be using, they would regard that as not a benefit to the company. Whether it is or is not is open to dispute.

But I think it is important for us in our factual investigation to try to get some sense as to the validity of the arguments of all the parties.

If the answer is you don't know, that is fine.

Mr. PRESSMAN. Mr. Chairman, they never told us. We don't know.

Mr. KOPKE. I have that. By New York State law they must provide that to you. I have those statistics, at least for our particular case.

Out of $1,179,000 in premiums, the loss—the projected loss for 3 years was $3,464,000. This is in the packet I submitted. Of those, paid claims were only $517,000. The rest is reserves.

Mr. FLORIO. Could you go through that once more, please?

Mr. KOPKE. That certainly inflates the loss ratio.

Out of let's say $1.2 million in premiums, the total loss projected for 3 years, let's say $3.5 million, $500,000 was paid to claimants on closed cases. The rest all remain open and as reserves.

Now, if you project that same proportionate settlement of the reserves, you will cut that at least by 80 percent, that reserve amount.

Mr. PRESSMAN. That verifies Ralph Nader's contention that they put more in reserves than is absolutely necessary.

Mr. KOPKE. That shifted in the third year with our company, because they realized the surplus they had to put away due to New York State insurance regulations. The surplus reduced significantly in the third year, in order that they still be able to write some insurance.

Mr. FLORIO. The reserves—we will get this from the insurance industry people as well—the reserves are a source of investment income or not?

Mr. KOPKE. I can't speak to that.

In New York State we have reviewed the possibility of self-insurance. We most likely will be doing that with all housing authorities and the Federal Department of Housing and Urban Development is looking seriously at it at the Federal level.

Mr. FLORIO. Mr. Lent.

Mr. LENT. I would just like to ask Mr. Pressman from Baltimore, when we talk about these reserves and we conclude that Ralph Nader is therefore right, aren't we overlooking an important point; that the States require the insurance companies to establish those reserves?

Mr. PRESSMAN. They are following the law, but they don't require them to inflate them, and that is what they have been doing.

Mr. LENT. You are saying that there are companies that you know that are keeping more—allocating more in reserves than the law requires them to?

Mr. PRESSMAN. Yes. I am saying that. And I——

Mr. LENT. Because most companies—my understanding is that when they have more money than they need to keep in reserve, they pay that out in dividends if they are a stock company, or they—that's a profit.

Mr. PRESSMAN. Fine. They like that. They want to pay dividends. They want to please their stockholders. But, they take advantage of people who are insured.

Mr. LENT. Well that is what we are trying to find out here, whether they are taking advantage. You know, we see that they are losing money. So we query whether they are taking advantage, or maybe the laws of Maryland or New York State require too much to be held in reserve.

But I think your story and your testimony demonstrates pretty well why a company might have to establish a reserve. You are pointing out with this chart, you say 18 years before 1985, you paid $6 million in premiums, and they only paid out $500,000. Therefore, their profit is $5.5 million.

But you also admit that in 1985 you had a big loss in Baltimore.

Mr. PRESSMAN. That's true.

Mr. LENT. And you are now looking for $3.3 million, which is probably a higher amount than the amount of the premium you paid in the year of the loss.

Is that right?

Mr. PRESSMAN. I maintain that the insurance company has no right to make up in one big rush, one big hurry, all the money that they had to pay out in 1985.

You carry insurance in order to get protection. You don't carry insurance in order to have to pay—make up for whatever the insurance company has to pay. You want protection.

You do not want to have to pay it back in a hurry.

Mr. LENT. Well, unlike some of these other witnesses, you have the ability as a municipality to self insure. And to a certain degree you have self-insured.

Mr. PRESSMAN. That's true.

Mr. LENT. But for whatever reason—and I don't know what it is, maybe you could tell us—you have not self insured with respect to property

Mr. PRESSMAN. We may be forced to. We may be forced to do it. But what I am saying is that cities like Sykesville should be considered, too. They cannot solve their problem by self insurance.

Mr. LENT. And in 28 States the community governments have convinced State legislatures to pass laws limiting the liability of municipal officers, city mayors, trustees, and so forth, and capping municipal liability awards.

I don't know whether Maryland is considering that.

Mr. PRESSMAN. I would say in Maryland we want to protect the people that need protection and we do not want to impose on those people who can't afford that protection.

Now in regard to the doctrine of sovereign immunity, I have always felt that there should be a limit, a very big limit on the use of that term, that the king can do no wrong.

However, I would suggest that from my viewpoint it would be acceptable if you would eliminate the punitive damages and just make those people whole, who were wronged by someone's negligence. And if something has to be done to protect those that need protection, then perhaps the way to go is by eliminating punitive damages.

Mr. LENT. I think that is one of the things the insurance industry will talk about later today, if we ever get to them, that these treble damages and punitive damages is something that is inflating the cost of insurance for municipalities, for one.

In Baltimore you have some Superfund sites, don't you? Toxic waste sites?

Mr. PRESSMAN. Yes, we do.

Mr. LENT. I know Congresswoman Mikulski has been very vocal about certain of those sites in the city of Baltimore.

Now, it is possible that claims will be filed by people who contend they were injured as a result of those—operation of those landfills, some of which are operated by the city. Is that correct?

Mr. PRESSMAN. That's true.

Mr. LENT. So, that maybe it is a good idea—and we have no way of knowing the extent or the magnitude, or how far back some of those claims will reach.

In Jackson Township in New Jersey, the town was sued for well contamination from landfills, and the judge went back years and years on old insurance policies and held the companies liable.

So, it is possible, I suppose, that in addition to that $3.3 million claim you have for the fire against that $6 million, you might have some landfill claims, toxic tort-type claims.

Mr. PRESSMAN. That's true.

Mr. LENT. That would reach back and the city of Baltimore might be darned glad they have got those reserves, that the insurance company had those reserves.

Mr. PRESSMAN. We carry our own self-insurance for that purpose. So, if we have any claims of that kind, that would—another thing I would suggest to be looked into is the matter of the rule that I believe is prevalent in all the States. And that is that when you have a child, a minor that is injured, that it could take 20 years before a claim is established. And it may be something for the States to consider. That is to make a change in that rule so that there would be a shorter period than 20 years before it is established as to how much is owed.

Mr. LENT. Well, some of these toxic torts, whether they are children or older people, may take 15, 25 years before they manifest themselves in a tumor or a lung problem.

Mr. PRESSMAN. That's very possible.

Mr. LENT. So, one of the problems the insurance companies have is that the occurrence or accident has been ruled by the courts not to take place in one cataclysmic instance, but in many cases over a period of years. And these companies—one company someone was telling me was held on a 1911 insurance policy in the 1980's. They reached back.

And in some cases, where a company had issued over a period of years on an annual basis, a policy to a company or a municipality—I forget what it was—the judge went back and stacked those policies one on top of the other and totaled up the liabili' '—let's say it was a $1 million policy—every year for 20 years. He said, well, your liability is $20 million, and added them all together.

So, the companies are pointing to the tort system.

Mr. PRESSMAN. Did the companies share—for all those years——

Mr. LENT. It was one company, they had been very faithful to one company and added it all up. Then there were other companies, other cases where they comingled the different companies.

I was wondering, as comptroller, if you could recommend to the city or the city council that they might not look at this self-insurance.

Or your reason for not going self-insurance may be that the risk is too great and you would rather palm that risk off on the insurance industry, insurance company.

Mr. PRESSMAN. When we set the tax rate we would like to know that the amount that is appropriated would do for the year, and that's it.

Mr. LENT. But you are self insured for toxic landfill, you are self-insured for automobile and liability.

Mr. PRESSMAN. We have the funds to take care of that, that are appropriated each year, in order to accumulate a fund.

Mr. LENT. Why do you have to carve out this one exception for property insurance?

Mr. PRESSMAN. It is more than an exception, in that we have a number of types of insurance that we have to carry, and we want to know that it is going to cost so much money for the year. And we would rather have it fixed.

In fact, the law requires that we have it fixed. We have the tax rate intact so that we know how much of a rate to charge each and every property owner.

Mr. FLORIO. Will the gentleman yield?

Mr. LENT. That is insurance. You are, in effect, setting up a type of an insurance system, are you not?

Mr. PRESSMAN. Yes.

Mr. FLORIO. If the gentleman will yield.

Mr. LENT. Yes.

Mr. FLORIO. I'm not sure I understand. You are not talking about anticipating long-term payout. You are talking about what you need for the year. You need a payout for the year of a premium, or you need a payout for a year of an appropriate contribution to a reserve if you are going to be a self-insurer.

Mr. PRESSMAN. For example, in 1914 the city of Baltimore went to a system of insuring over $200,000 and less than $2 million. This has proved to be very advantageous from the taxpayer's standpoint, because it cost us a great deal less money to do that, instead of insuring for everything.

Previous to 1914, we had insured the whole amount, just by buying a policy. But there is an example where we have benefited from using a deductible in the insurance in order to establish how much money will be needed each year.

And each year we have a certain amount allocated and appropriated for that fund until it grows to the point where, when it reaches $2 million, you don't need any more.

Mr. FLORIO. Let me express my appreciation to the panel. Thank you very much——

Mr. LENT. Mr. Chairman, I just wanted to touch on this. Since I am a New Yorker, I was interested in some of the figures on insurance for public housing. And Mr. Kopke covered that.

You indicated in your testimony that between 1978 and 1981 you were paying $22 a unit?

Mr. KOPKE. Yes; each unit per year. So we multiplied that by number of units, of course, to get our yearly premium.

Mr. LENT. That just appears to me to be kind of a low—I have a house and the homeowner's policy is $400, I think, roughly give or take.

So, it was $22 a unit?

Mr. KOPKE. Correct.

Mr. LENT. Then from 1982 to 1985 it dropped to $8.50 a unit.

Mr. KOPKE. Correct.

Mr. LENT. Then in 1986 it is going back up.

Mr. KOPKE. $123.

Mr. LENT. I thought the final bid was $55 a unit.

Mr. KOPKE. No; we have not received—we received an offer of $55, which was withdrawn before we signed the contract. The only one we have received was in an open, competitive bid nationally from a firm out of Arizona. The insurance company is out of Arizona, Great Global. And that was from—it was $120 for each and every unit.

Mr. LENT. I am just reading from your testimony. A Schenectady housing authority managed to get an offer from Alexander & Alexander, a Texas firm——

Mr. KOPKE. That's the one that was withdrawn.

Mr. LENT [continuing]. For coverage for $55 a year.

So, you are falling back to the Connally quote, which was $123 per unit.

Mr. KOPKE. Right; and that, in fact, was withdrawn as of the end of August.

Mr. LENT. What is the average population of a unit? Two, three?

Mr. KOPKE. About 3.3 persons per apartment.

Mr. LENT. So what are we talking about in Schenectady?

Mr. KOPKE. Approximately 3,500 individuals. That is in the public housing portion.

We have another 750 in a private rental arrangement, which again would be about 2 or 3 people. Some 4,500 people.

Mr. LENT. But the final, what these folks are going to have to pay is $123 a unit. Is that like a two-bedroom?

Mr. KOPKE. That would be a two-bedroom apartment. Correct. What that would break down to would be on a different chart. We break them down per unit per month, so we can have it based on their rent, which comes to $23.92 per month for insurance coverage at the $120 unit premium.

Mr. LENT. Then you point out in your testimony that the loss ratio is 293 percent.

Mr. KOPKE. Correct.

Mr. LENT. So, unlike the testimony of the nurse-midwives who have a very low loss ratio——

Ms. MCHUGH. Very low.

Mr. LENT. You have one where the company was obviously losing money at $293——

Mr. KOPKE. Right; that was as a result, in our opinion, of the unusually low rate that was used.

If you use the 1978 to 1981 rate, they broke even.

Mr. LENT. During those years, presumably, you made out?

Mr. KOPKE. No question about it.

Mr. LENT. Then it went up in subsequent years.

Mr. KOPKE. It is the same philosophy of making up in one chunk for a loss period.

I can understand businesswise, I would be making up for a loss also.

Mr. LENT. OK. Thank you very much.

Mr. FLORIO. That's an interesting point, your last point. If one follows the suggestions of Mr. Hunter or Mr. Nader in terms of their analysis, the world view of insurance, your example with the housing authority seems to verify what they are suggesting is reality. The $22 was there. In fact, has been reduced inappropriately, they would suggest, to compete for dollars in order to invest.

As a result of that and the loss ratio you have, it is now going up, they would say, to an extraordinary degree.

But, if the appropriate rate, that is the $22 that is appropriate—presumably somebody determined it was appropriate—had been contained, and a 5-percent add on to that as they suggested, the insurance industry would still be doing well in this little microcosm example.

Mr. KOPKE. We are anticipating a self funded program where we charge ourselves probably between $50 and $70 a unit. But then we would not have to contribute if the pool was not dwindled, did not dwindle over a period of time. And then we contribute as necessary.

Mr. LENT. That fund would then be exposed to self-insurance claims by not just the families that lived there, but by visitors?

Mr. KOPKE. A good deal of our claims are from visitors.

Mr. FLORIO. Yes, ma'am.

Ms. MCHUGH. I would just like to again reiterate that it is fine for the gentlemen at the other end of the table to be telling us their figures. But, at least they have an offer to deal with. We have no offers, and we are facing people every day going out of business because we have nothing even to negotiate with somebody.

There are small groups like us who are just falling by the wayside in the middle of this chaos in the insurance industry.

Mr. FLORIO. I find your situation very difficult to understand because I am working from the assumption that the insurance companies want to make money, and there is nothing, certainly, wrong with that. And why it is that someone has just talked away from what, on its face, appears to be a legitimate moneymaking opportunity.

Maybe from our next panel we can get some clarification on it.

Mr. LENT. Mr. Chairman, if I could just pursue that, because I didn't ask the nurses any questions.

But you are able to get insurance, are you not, up to the first $100,000?

Ms. McHugh. We have a tentative offer from a primary company to be the primary insurer for $100,000. However, we have made it clear that is inadequate for our membership, and they have not been able to find reinsurance, even to bring it up to a $500,000 level.

Mr. Lent. Why is $100,000 worth of insurance so inadequate, if you have such a great experience?

Ms. McHugh. Because most hospitals, in order to get staff privileges, require $1 million coverage, just like they do for physicians.

Mr. Lent. I see.

But as far as you are concerned, you could live with $100,000?

Ms. McHugh. I think most members of the profession would prefer the million-dollar coverage. However, the reality is that most nurse-midwives work in hospitals and——

Mr. Lent. And these hospitals have these requirements?

Ms. McHugh. That is correct. That is a nationwide standard.

Mr. Pressman. Mr. Chairman and members, I commend you for going into this very pressing problem.

Mr. Florio. Thank you very much.

We are now pleased to have as our next panel Mr. Frank Nutter, president of the Alliance of American Insurers; Mr. T. Lawrence Jones, president, American Insurance Association; Mr. John Crosby, vice president and general counsel, National Association of Independent Insurers; Ms. Mavis A. Walters, senior vice president of Insurance Services Office.

STATEMENTS OF FRANK NUTTER, PRESIDENT, ALLIANCE OF AMERICAN INSURERS; T. LAWRENCE JONES, PRESIDENT, AMERICAN INSURANCE ASSOCIATION; JOHN B. CROSBY, VICE PRESIDENT AND GENERAL COUNSEL, NATIONAL ASSOCIATION OF INDEPENDENT INSURERS; AND MAVIS A. WALTERS, SENIOR VICE PRESIDENT, INSURANCE SERVICES OFFICE, INC.

Mr. Nutter. Mr. Chairman, members of the committee, we applaud the initiative of this committee in examining issues surrounding the availability of insurance for certain commercial enterprises.

We of the Alliance of American Insurers share the concern of public officials, State and Federal, business, and the general public about developments leading to restricted insurance coverages and affordable insurance protection.

The property/casualty insurance industry is deeply disturbed about the actions it has felt compelled to take in certain lines of insurance, and for selected types of coverage, and indeed welcomes the commitment of affected policyholders and public policymakers in restoring the environment in which these businesses operate to the legal and regulatory stability needed to provide a responsive insurance market.

Changes in our social, legal, and business relationships cause uncertainty in our ability as individuals and as businesses to assess risks we undertake. Insurance is closely integrated in all such rela-

tionships and is affected by these changes and by any destabilizing factors operating in the legal or commercial environment.

A business or profession's inability to assess its risks is shared by its insurer; an insurer's inability to assess that business' potential liability exposure will in turn affect its policyholder.

The property/casualty insurance industry is not monolithic. As each company evaluates its capacity to provide coverage and the risk exposure of its policyholders, present or prospective, it can respond in only two ways; through its rates and the coverage it is willing or unwilling to offer.

These individual actions have in recent months created availability and affordability problems in certain lines of insurance. These problems have highlighted for insurers and the affected policyholders, the necessity of addressing the underlying legal and regulatory developments which have given rise to uncertainty in the commercial environment in which these businesses operate.

For each affected line of insurance for which availability or affordability problems have emerged, there exists a unique business endeavor and a unique business environment, legal and commercial. The underlying problems vary for each environment and deserve tailored solutions.

In our testimony, Mr. Chairman, we have identified those lines of insurance for which we see availability problems and the underlying problems. But, I would like to highlight what we see as three recurring themes in these areas.

The first such theme is the uncertainty in today's legal environment in which business operates. This uncertainty is marked by a spider's web pattern of developments:

A shift in the courts from rules of liability based on fault to strict liability by which injury or wrong is compensated regardless of fault;

Dramatic increases in the transactional costs associated with resolving disputes;

A societal expectation of entitlement for monetary recovery for every wrong, no matter how inconsequential but nearly always well beyond economic costs;

A continual and rapid evolution of theories of liability leaving tomorrow's tort law in a perpetual state of uncertainty;

A rapid change in the expectation of people for the duty owed them by Government, business, and other citizens;

Judicial and legislative embrace of full liability for each party contributing to an injury rather than the application of several and identifiable culpability.

Many of today's availability problems flowing from the actions of insurers can be translated into this message: Insurers are not the bankers of the tort system, and insurance, although perhaps the most efficient risk distribution system ever devised, cannot finance its uncharted and undescribable growth.

The second recurring theme in each availability insurance problem is the insurance industry's own financial plight, collectively and individually.

In the aggregate, the industry is expected to complete 1985 as the 7th consecutive year of staggering underwriting losses. While 1984-85 appear to be watershed years for an industry turnaround,

the insurance coverages for these troubled lines are difficult underwriting challenges and generally proven unprofitable lines.

In this environment an insurer must decide in which lines to commit its capacity while seeking to assure its solvency and provide for the insurance needs of the greatest number of its policyholders. All insurers do not write all coverages. Often only a few companies have provided insurance for a particular commercial activity.

When a major company or companies writing one of these difficult lines must, of financial necessity, shift its capacity, insurance availability becomes an immediate problem. Other carriers not having the underwriting expertise, or perhaps the financial resources, cannot easily fill the void, particularly for coverages which stand alone and are not integrated with other insurance coverages.

The third recurring theme is the problems in the regulation of businesses affected by these availability problems. In certain of these areas insurers have difficulty in risk assessment for lack of regulatory controls or standards, and in others for burdensome regulatory requirements.

Although insurers seek to mitigate uncertainty by encouraging loss control and safety engineering, insurers lack enforcement authority. Without Government licensing and operational standards or meaningful private sector self-regulation, insurers and the businesses they insure cannot easily evaluate acceptable business and professional practices.

On the other hand, imposition by Government regulation of unmanageable legal standards or financial responsibility requirements that are not achievable by the businesses or their insurers beg for insurance availability problems.

Insurers recognize the social and commercial necessity of their product, as well as the integration of insurance with sound public policy. The underlying problems in the environment of certain businesses as reflected in availability and affordability problems for certain coverages deserve thoughtful solutions by insurers, their policyholders, and public policymakers. These problems do not exist in all lines of commercial insurance, nor in all States, nor to the same degree in each affected commercial activity.

The prospective solutions vary in their applicability to each such problem and to segregated geographical areas where the problem has surfaced. What is clear is that the solutions should not be limited to insurance.

What is needed in nearly every such troubled line is a stable business and legal environment. What is required to achieve that varies by the nature of the underlying problem.

We of the property/casualty insurance industry are working with insurance departments and affected businesses and individuals in all of those States where problems have been identified.

We are not in the business of not providing insurance. It is in our interest to do so, and it is right as a matter of sound public policy that we do so.

Thank you, Mr. Chairman.

[Testimony resumes on p. 208.]

[The prepared statement of Mr. Nutter follows:]

STATEMENT

OF

FRANKLIN W. NUTTER

Mr. Chairman, we applaud the initiative of this committee in examining issues surrounding the availability of insurance for certain commercial enterprises. We of the Alliance of American Insurers share the concern of public officials, state and federal, business and the general public about developments leading to restricted insurance coverages and affordable insurance protection. The property/casualty insurance industry is deeply disturbed about the actions it has felt compelled to take in certain lines of insurance and for selected types of coverage and indeed welcomes the commitment of the affected policyholders and public policy makers in restoring the environment in which these businesses operate to the legal and regulatory stability needed to provide a responsive insurance market.

Changes in our social, legal, and business relationships cause uncertainty in our ability as individuals and as businesses to assess risks we undertake. Insurance is closely integrated in all such relationships and is affected by these changes and by any destabilizing factors operating in the legal or commercial environment. A business or profession's inability to assess its risk is shared by its insurer; an insurer's inability to assess that business' potential liability exposure will in turn affect its policyholder.

The property/casualty insurance industry is not monolithic. As each company evaluates its capacity to provide coverage and the risk exposure of its policyholders, present or prospective, it can respond in only two ways--through its rates and the coverage it is willing or unwilling to

offer. These individual actions have, in recent months, created availability and affordability problems in certain lines of insurance. These problems have highlighted for insurers and the affected policyholders the necessity of addressing the underlying legal and regulatory developments which have given rise to uncertainty in the commercial environment in which these businesses operate.

For each affected line of insurance for which availability or affordability problems have emerged, there exists a unique business endeavor and a unique business environment, legal, and commercial The underlying problems vary for each environment and deserve tailored solutions.

We follow with a review of each insurance availability problem and the underlying causes unique to the problem. It is of note, however, that three recurring themes emerge from a review of each issue. The first such theme is the uncertainty in today's legal environment in which business operates. This uncertainty is marked by a spider's web pattern of developments:

1. a shift in the courts from rules of liability based on fault to strict liability by which injury or wrong is compensated regardless of fault;
2. dramatic increases in the transactional costs associated with resolving disputes;
3. a societal expectation of entitlement for monetary recovery for every "wrong" no matter how inconsequential but nearly always well beyond economic costs;

4. a continual and rapid evolution of theories of liability leaving tomorrow's tort law in a perpetual state of uncertainty;

5. a rapid change in the expectation of people for the duty owed them by government, business, and other citizens; and

6. judicial and legislative embrace of full liability for each party contributing to an injury rather than the application of several and identifiable culpability.

Many of today's availability problems flowing from the actions of insurers can be translated into this message: Insurers are not the bankers of the tort system and insurance, although perhaps the most efficient risk distribution system ever devised, cannot finance its uncharted and undescribable growth.

The second theme which recurs in each availability insurance problem is the insurance industry's own financial plight, collectively and individually. In the aggregate, the industry is expected to complete 1985 as the seventh consecutive year of staggering operating losses. While 1984-1985 appear to be watershed years for an industry turnaround, the insurance coverages for these troubled lines are difficult underwriting challenges and generally proven unprofitable lines. In this environment, an insurer must decide in which lines to commit its capacity, while seeking to assure its solvency and provide for the insurance needs of the greatest number of its policyholders. All insurers do not write all coverages. Often only a few companies have provided insurance for a particular commercial activity. When a major company or companies writing one of these difficult lines must

of financial necessity shift its capacity, insurance availability becomes an immediate problem. Other carriers not having the underwriting expertise or perhaps the financial resources cannot easily fill the void, particularly for coverages which stand alone and are not integrated with other insurance coverages.

The third recurring theme is problems in the regulation of the businesses affected by these availability problems. In certain of these areas insurers have difficulty in risk assessment for lack of regulatory controls or standards and in others for burdensome regulatory requirements. Although insurers seek to mitigate uncertainty by encouraging loss control and safety engineering, insurers lack enforcement authority. Without government licensing and operational standards or meaningful private sector self-regulation, insurers and the businesses they insure cannot easily evaluate acceptable business and professional practices. On the other hand, imposition by government regulation of unmanageable legal standards or financial responsibility requirements that are not achievable by the businesses or their insurers beg for insurance availability problems.

<u>Municipal Liability</u>

The municipal liability problem can be traced to the erosion of a well-settled principle of law that governmental entities could not be sued without their consent. That is, the federal and state governments

and municipal corporations which have power to legislate, as well as counties, townships, and unincorporated divisions of a state, traditionally were not liable for damages for their neglect of public duty.

Since the mid-1970s, state legislatures and the judiciary have significantly eroded the doctrine of sovereign immunity, particularly as regards to municipalities. In some cases, amendments to state constitutions or changes in state laws totally or partially abolished sovereign immunity as applied to local units of government, particularly as to municipalities. In addition, the courts generally hold that where the legislature by statute abrogates the immunity of the state from liability, such laws also repeal the immunity of municipal corporations, counties, towns, and all other political subdivisions of the state.

The judiciary has played a significant role in eroding the common law doctrine of sovereign immunity. Courts have used numerous theories to find governmental entities liable. Typically, courts have held that governments are immune in their "governmental" functions, but are liable in their "proprietary" functions. Other courts have distinguished between the general duty to the public and special duties or relationships with a specific citizen, and have found liability in the latter situation. Governmental entities have also been held liable for damage caused by nuisance, and injuries caused by

the use of highly dangerous agents, instrumentalities, or substances. Finally, governmental entities have been held to have waived their immunity to the extent that they have purchased liability insurance. None of these judicial erosions are based on the constitutionality of the sovereign immunity doctrine, but are rather judicially created distinctions.

Not only have the courts eroded the doctrine of sovereign immunity, they also found other avenues to create liability where none previously existed. The courts have held municipalities liable for violation of the constitutional rights of citizens and have also required municipalities and other local government entities to indemnify claims against municipal employees.

Recent surveys indicate the dramatic growth in the size of judgments and awards against cities. Based on a 1982 survey of 937 cities, the largest amount sought was $40 million. In 1985, the 1,244 cities surveyed responded that the average claimed was in the $100-$200 million range. The average award jumped from $230,000 in 1982 to $2 million in 1985. Additionally, the number of lawsuits filed against public officials doubled since 1982.

Solutions to these problems are being actively considered by states, including the reestablishment of sovereign immunity, at least on a basis limited to certain defined activities; the adoption of better

risk management activities (e.g., equipment maintenance, loss control plans); improved safety plans; the elimination of some hazardous municipal series (e.g., hazardous substance treatment or disposal); and limitations on recovery of damages sought in citizen suits.

Day Care

Insurance availability problems associated with professional and family day care providers are of recent origin. Publicity associated with sexual and physical abuse in day care facilities is expected to increase both the frequency and severity of insurance claims. The potential of judicial application of absolute liability and the probable delayed development of claims resulting from long term evaluation of the day care providers have made underwriters cautious. Attorneys are now seeking to circumvent policy exclusions for sexusl, physical, and criminal abuse by alleging negligent hiring in day care centers.

A major problem in this field is the lack of licensing, background checks, regulations, inspection and standards for the family or home-based day care provider. While these day care services may appear on the surface as casual day care accommodations, many are indeed businesses and should be treated as such.

Insurers are working with insurance commissioners and legislators in several states to assure a viable insurance market for the

professional and family day care providers. This includes evaluation of homeowners insurance coverages to identify and define and distinguish the family day care provider as a business enterprise and as child care accommodation.

Liquor Liability (Dram Shop)

A recent National Commission Against Drunk Driving study estimates that half of the 43,918 U. S. motor vehicle fatalities in 1984 were alcohol-related, based on data from 16 states that test the blood alcohol levels of all drivers involved in serious accidents. The frequency of alcohol-related traffic accidents and fatalities is currently receiving widespread public attention.

There has been strong public clamor over the past decade for enactment of stricter laws aimed at reducing the number of intoxicated drivers on the road and for enforcement of those laws once they are enacted. Another perceived means of deterring drunk driving is the enactment of "dram shop" laws which specifically establish the civil liability of a liquor licensee who sells or provides alcohol to a minor or other intoxicated person who later causes a motor vehicle accident.

Over two-thirds of the states have either dram shop laws or common law liability for the sale of liquor.

In most states, the current availability problem in liquor liability insurance is primarily for those liquor licensees who try to secure only dram shop insurance (monoline coverage) rather than for licensees who secure insurance as one part of a commercial lines insurance package.

Even when dram shop coverage is written as part of the commercial insurance package, commercial lines underwriters on both new and renewal business are looking at the individual insured more selectively in terms of risk characteristics and claims experience.

The reason is primarily the increased public awareness of the dangers of drunk driving, which in turn has led to the recent large court verdicts and settlements in dram shop cases. In the changing climate surrounding liquor laws, insurers believe that they can no longer adequately assess their exposure under dram shop policies.

The dram shop availability problem has also been severely aggravated by the financial difficulties of some of the major insurers of this line.

One of the effective solutions to the dram shop coverage problem has been developed by the liquor licensees themselves. Many of the restaurant and tavern owner trade association groups, through their publications and meetings, are developing effective programs to

encourage responsible liquor consumption by the public. Activities by the liquor licensees include elimination of happy hours, curbing of 2-for-1 drink offers, elimination of ladies' nights, and development of "designated driver" programs.

Another effective solution to unavailability of dram shop insurance is legislation to abolish or improve the dram shop laws and to implement tort reform both generally and specifically as that reform relates to liquor liability. Laws were introduced in several states to abolish or severely limit dram shop liability on the basis that such liability should rest solely or primarily with the intoxicated person.

In addition, insurance coverages can be more predictable if a reasonable limit or cap on damages which may be awarded under a dram shop statute, both per person and per incident or occurrence is instituted.

Medical Malpractice and Nurse-Midwife

Until recently, medical malpractice insurance suffered less from availability problems than affordability problems. Recently, however, the availability of coverage for certain specialties have emerged. These include nurse-midwives, obstetricians, gynecologists, and family practitioners doing some obstetrics and pediatrics. In addition, insurers, including non-traditional insurers such as those owned by the medical profession, have reduced contract limits and coverages.

Insurance coverage for nurse-midwives that is not integrated into a complete insurance package for physicians and related professions has been difficult to place. Insurers are concerned about the training and experience of those in this profession in light of the degree of risk and potentially high liability exposure associated with their medical practice.

Medical malpractice insurance is written both by specialty writers, usually physician sponsored, and insurance companies. In addition, 10 states have active joint underwriting associations comprised by law of licensed insurers in the state. In 1984 more than half of all medical malpractice premiums were written by specialty writers. Of the top 20 companies, 12 are specialty writers and, with the exception of 2 or 3, all were formed after 1975. Over the period 1980-1984, nationwide, the combined medical malpractice carriers reserved $1.61 in claims and administrative expenses for each premium dollar earned. The obvious financial problems associated with this financial picture, however, are limited to a few states where rate increases have been inadequate. Thus, a core problem associated with inadequate medical malpractice coverages is the lack of adequate rates approved by insurance departments to support growth in capital and surplus. Inadequate rates give rise directly to solvency and financial concerns and limitations on coverage availability.

The reforms suggested for medical malpractice proceed from the basic notion that the availability problem can be managed if the rise in

claims frequency and severity can be controlled, if incidents of actual malpractice can be reduced in number, and if the predictability of long-term risks can be increased for companies writing coverage.

Peer review in the medical profession is vital and must be made more effective in reducing the incidence of malpractice. Mandatory sanctions should be provided by statutory enactment so that not all decision-making in peer review will remain discretionary. Doctors and other health care providers should be required to report their open and closed claims record prior to licensing, and a claims record including a specified number of awards over a certain amount during a specific time period should be established as grounds for mandatory non-licensing or suspension of a license.

Hospitals should institute risk management programs which will monitor the competence and claims records of practitioners and which will impose sanctions if standards are not met. Hospitals should require disclosure of claims records including all judgments, settlements, and pending claims before granting privileges.

Immunity should be provided by statute for all persons engaging in good faith in peer review or reporting.

The most effective option addressing the medical malpractice availability problem is tort reform. One of the most significant of

these tort reforms is the enactment of caps or limitations on the total amount of damages which may be awarded in a malpractice action. Where the enactment of a comprehensive cap covering all damages is not feasible, a cap covering the damages most susceptible to jury inflation, non-economic damages, should be enacted. Non-economic damages include pain and suffering, loss of consortium, loss of society and emotional distress. An absolute bar to the award of punitive damages should be enacted; where this is not possible, caps should be imposed, and a higher standard of proof should be required which would ideally limit awards to only those cases where willful and wanton action, fraud or malice can be shown beyond a reasonable doubt.

A group of reforms which deals chiefly with procedures for bringing and conducting malpractice suits have been suggested. A plaintiff should be required to file a notice of intent to sue prior to filing a complaint, and should be required to accompany his complaint with a certificate of merit from a health care provider of the same specialty as the practitioner being sued. Mandatory alternate dispute resolution mechanisms should be enacted. All claims should be required to go through a screening panel to determine if there is a reasonable likelihood that the plaintiff is injured as claimed.

Sanctions, including award of attorneys' fees and costs, should be taxed against plaintiffs bringing frivolous claims. Provisions making

inadmissible evidence of a plaintiff's compensation from other sources should be abolished, and a provision for the offset of collateral sources should be put in place. Provisions stipulating that the partial payment of a claim shall not be construed as an admission of liability, and that evidence of such partial payment is inadmissible should be enacted. New standards for expert witness should be enacted requiring that they be licensed practitioners of the same specialty and from the same locality as the defendant practitioner.

Courts should require medical malpractice juries to bring back itemized verdicts, separating awards into amounts for economic and non-economic damage and into amounts for present and future damages. Courts should allow the payment of awards by means of structured settlements; periodic payment of awards should be allowed where the parties agree to such payment.

Directors and Officers Liability

Some problems in the availability of insurance for directors and officers of corporations have been identified.

The coverage limitations and rate increases stem in large part from the well publicized financial and management problems of the U. S. banking system. Specifically, these problems have generated insurance claims not heretofore experienced:

- Banks suing some of their own managers and officers and attempting to collect on their insurance.

- Federal agencies that insure failed banks suing former officers and directors for mismanagement.
- Court decisions holding officers and directors to an increasingly strict standard of conduct by reducing the scope of the "business judgment" rule.
- Decisions made when a bank is unhealthy (as the industry has recently been) tend to generate more lawsuits.

Solutions being pursued include coverage changes to exclude certain volatile liability to allow broader coverage for standard risks and the evaluation of bank captive insurers and bank insurance pools.

Motor Carrier Liability

Against the background of generalized property/casualty insurer problems, the requirements for high limits of liability as mandated by the Motor Carrier Act of 1980 and the Bus Regulatory Reform Act of 1982 have placed a severe strain on the capacity of insurers and on their ability to accurately ascertain a financially sound course of action.

In addition to excessive financial responsibility limits of these statutes, other reasons for the current problems include:

- Deterioration in the quality of risks, particularly with regard to marginal operators and new operators who are less financially stable and have no safety record in their operations.
- Further, a number of states including Colorado, Connecticut, Indiana, and Pennsylvania have enacted or introduced within the last year, legislation which extends the federal financial responsibility requirements to risks operating intrastate.

Solutions to availability problems include the redefinition of the types and sizes of motor carriers and passenger carriers required to carry the higher limits. In this context, an attempt should be made to exempt local carriers operating only intrastate from the federal requirements, leaving them to be separately regulated by the states. Other exemptions might be considered for carriers having only slight exposure to loss, based on maximum quantity and/or frequency of hazardous materials carried.

Asbestos Removal

Because of federal pressure to survey public buildings, particularly schools, for asbestos exposure and to remove or encapsulate the asbestos discovered, there has been a rapidly developing market for asbestos abatement contractors and rising parental concern about asbestos in the schools. Efforts are being made to do something about asbestos in a relatively short time. Consequently, the demand for contractors exceeds the supply of qualified and experienced contractors. While some of those that have been in the business and have established a relationship with an insurer probably are able to find general liability coverage, others have not. Those that are new to the business are having the greatest difficulty in finding coverage.

Insurers are reluctant to provide coverage because of the inexperience of many contractors, the concern about the long latency diseases associated with asbestos, their bad experience with asbestos product claims, the

lack of accepted standards, fear that state-of-the-art performance will pose no protection from future findings of liability, the likelihood of only a limited business relationship with the contractors involved, limited knowledge of the degree of hazard of asbestos in a nonwork setting, and a reluctance to risk surplus in a new area. Furthermore, asbestos once removed must be disposed of creating the potential for a future Superfund-type liability.

We suggest that states need to develop standards for removal of asbestos, license those involved and provide either immunity or furnish hold-harmless agreements to contractors for non-negligent behavior in compliance with governmental standards.

Pollution Liability

At the center of problems associated with the availability of pollution liability insurance is the fact that liabilities against policyholders for cleanup, personal injury, and property damage are created by multiple federal and state statutes as well as by common law. Interacting with is are court interpretations of prior insurance contracts expanding coverage beyond that which insurers intended. As a result, availability of insurance for current pollution liability is significantly influenced by insurers' concern about potential unanticipated past liability; the magnitude of potential pollution liability, both past and future; the seeming inability to use contract language to prudently limit insurers' exposure; the complexity and expense of underwriting the coverage; the

unsettled state of the technology used to dispose and clean up toxic and hazardous substances; the fact that demand for coverage has been confined mostly to entities with a high probability of sustaining large losses, causing problems in risk spreading; and a civil justice system that continues to create new theories of liability and to expand older theories.

Further adding to insurer's uncertainty is that these other events occurred at a point in time when environmental impairment liability insurance was just beginning to be offered by relatively few writers and little claims data was available.

In discussing solutions, it is necessary to separate fundamental solutions from short-term transitory ones. Furthermore, solutions for one statutory problem may have relevance in other settings but require separate action. Amendments to the Federal Comprehensive Environmental Response, Compensation and Liability Act (CERCLA), the Superfund law, also would be applicable to the state copies of Superfund (about 40 states). Moreover, amendments may be necessary to one law only to increase the likelihood of coverage under another. For example, one factor in the lack of available insurance to meet the financial responsibility requirements of the Resource Conservation and Recovery Act (RCRA) is the fear that today's RCRA sites will become tomorrow's Superfund cleanup target. It also must be recognized that sometimes two events converge to produce a problem. For example, the insurer problems

with Superfund are the result of the provisions of the Superfund law, as administered by the EPA, interacting with state court decisions reading out coverage limitations or exclusions in insurance policies regarding pollution liability.

Problems under the federal Superfund law include:

- o Retroactive Liability--The provisions of the Superfund law apply retroactively to owners and operators of waste sites, transporters, and those who generated waste disposal at the site.
- o Strict Liability--Liability exists even though the responsible party's acts or omissions were not the proximate cause of the leak and even though the substance leaking is not that deposited.
- o Joint and Several Liability--The majority of courts ruling have held responsible parties jointly and severally liable and ignored degree of contribution to the toxic site.
- o Excessive Transaction Costs--The present responsible party approach to Superfund combined with joint and several liability has resulted in high transaction costs. The monies spent by EPA could better be used to clean up sites while insurers have faced investigation and legal costs that frequently are far in excess of any potential Superfund cleanup share.

We support amendment of the Superfund law to provide that policies written before Superfund was first enacted in 1980 cannot be interpreted to cover pollution liability for losses occurring prior to that date. It is our preference that the amendment be applied to state law as well. We also support other critical amendments to Superfund reauthorization. Modifications of the law's joint and several liability provision which could relieve some pressure on insurers in retroactive cleanup cases include (1) a

defense for de minimis contributors to toxic waste sites; and (2) an apportionment requirement. A state-of-the-art defense for toxic waste generators, transporters, or disposers would help to assure fair application of standards.

We also support changes the EPA could make in administrative practices to avoid the transaction costs faced by de minimis potentially responsible parties.

Conclusion

Insurers recognize the social and commercial necessity of their product as well as the integration of insurance with sound public policy. The underlying problems in the environment of certain businesses as reflected in availability and affordability problems for certain coverages deserve thoughtful solutions by insurers, their policyholders and public policymakers. These problems do not exist in all lines of commercial insurance, nor in all states nor to the same degree in each affected commercial activity. The prospective solutions vary in their applicability to each such problem and to segregated geographical areas where the problem has surfaced. What is clear is that the solutions should not be limited to insurance. What is needed in nearly every such troubled line is a stable business and legal environment. What is required to achieve that varies by the nature of the underlying problem.

We of the property/casualty insurance industry are working with insurance departments and affected businesses and individuals in all of those states where problems have been identified. We are not in the business of not providing insurance. It is in our interest to do so and it is right as a matter of sound public policy that we do so.

We appreciate the opportunity to address the issues of concern to this Subcommittee, and want to work with you and the individual states to solve these difficult issues of availability, and affordability of liability insurance.

STATEMENT OF T. LAWRENCE JONES

Mr. JONES. Mr. Chairman, I am Larry Jones, president of the American Insurance Association. And my responsibility here on the panel is to identify that the problem is liability coverages. That is what is really causing this problem in bringing the letters to you and otherwise.

The underlying problem there is the unpredictability of what the courts will do, what the judges and juries will do. We are in a trend of greatly expanding liability responsibility and of much higher awards and new elements of damage.

Most dramatic and drastic and troublesome for us has been the environmental coverages. You have been deeply engrossed in those problems. But we have found that we are unable to provide environmental liability coverages. At the very base is the fact that we do not have the technical knowledge—I mean, society doesn't have the technical knowledge to contain these toxic chemicals and toxic wastes. We have landfills that leak, permeate and create liability.

What troubles us here most was in 1980 they enacted the Superfund law. We had early in 1970 endeavored to take environmental liability out of our policies, because it was a risk that we were not able to appraise yet.

After they enacted the Superfund law, we endeavored to develop a policy. We did develop a policy to write, and we started writing it. And then the courts held that there was going to be strict joint, and several liability retroactively applied. That was not written into the law, but that is what the court said. And that made it impossible for us as insurance companies to appraise the risks that we were undertaking. We might write a policy on a trucking firm that carried some wastes to sites and found that that person might be sued to clean up the whole site.

And so these were exposures that we were unable to measure.

Mr. FLORIO. That, of course, has nothing to do with prospective liability.

Mr. JONES. It is prospective liability.

Mr. FLORIO. You have indicated you were writing policies in accordance—to the degree that you are writing any, you have any inclination to writing any, writing them with an awareness from this point forward you will charge premiums, you will exclude whatever you will exclude.

The Superfund cleanup activities goes to the interpretations—reference is made to the *Jackson Township* case—go to the interpretations of existing contracts at the time of the liability of coverage under those policies.

That is a different thing than saying that somehow one is now changing the liability standards.

Mr. JONES. We, of course, said that a policy did not cover seepage in the *Jackson Township* case.

Also, no one had ever heard of an element of damage being a trust fund for medical monitoring for a 20-year period. Those are unpredictable things.

I am very sympathetic with the people that made these decisions in insurance companies.

Mr. FLORIO. Except, this has nothing to do with your underwriting standards from this point forward. Why would you be denying someone coverage from this point forward with that awareness, whether you are correct or incorrect, with that awareness there is nothing to prohibit you from writing coverage from this point.

Mr. JONES. You are saying we should assume that that is the law. We are not assuming that that is the law.

Mr. FLORIO. I assume you are not assuming that is the law. But you write the policies.

Mr. JONES. We are not writing policies——

Mr. FLORIO. That's the point. Why is it you are not writing?

Mr. JONES. Because it is unpredictable what the losses will be.

Mr. LENT. Unpredictable what the court will do?

Mr. JONES. It is unpredictable what the court will do. It is a changing environment. If it was stable we could write it regardless of the amount of money involved. But that would raise the question of affordability.

Mr. LENT. What you are saying, as I understand it, if you write a new policy tomorrow or a week for a year in futuro, you limit your liability for x million dollars, and you exclude pollution, toxic. You have no way of knowing whether a court construing that policy 4 or 5 years down the line might not do the same, follow the same precedents of a judge who, in 1984, construed a 1924 policy to go much further and provide much greater——

Mr. JONES. You are exactly correct, sir.

Mr. LENT. In other words, the words in the contract don't limit the court.

Mr. JONES. That's right.

Mr. FLORIO. I apologize for interrupting you. Why don't you just go ahead.

Mr. JONES. The responsibilities of the cities have been greatly expanded. For many years we regarded the policy function as a governmental function. And there was a certain amount of immunity involved.

But the Congress and states have passed civil rights laws and under the civil rights laws the cities are getting suits against the policy.

The greatest number of suits against the policy come from inmates already in jail. They say we were not protected from other inmates, we were not treated properly, we contracted some disease while we were in jail. And this has greatly expanded in an unpredictable way, the liability for cities.

Now the cities have been greatly impacted by the environmental pollution problem because they maintain city dumps—they have to. We give them a nice name name, landfill.

Mr. LENT. Sanitary landfill.

Mr. JONES. Sanitary landfill. But it is a city dump. And it is unreasonable for them to maintain control over who puts what in a city dump. They become contaminated. EPA sues the city for cleanup of the site. And it is a liability that is suddenly passed upon them that they don't know the measurement of, and we don't either, yet.

And we know that they don't know scientifically how to contain one of these city dumps, keeping it from contaminating.

It is this greatly expanding coverage, or extent of liability and what the courts do that have caused a great deal of uncertainty on the part of the insurance companies and those that have to make those decisions of what risks they will take, and at what price they will take them.

It is a changing period.

Now, as Mr. Nutter says, it is very unfortunate that we are going through this period and we are having these problems.

If I can endeavor to explain the midwife problem. First, from an insurance point of view, it is a relatively small universe. As I understood, there were 2,800 midwives and 1,400 of those, and probably the ones that were best regarded in the profession, were in one policy. And that company, the testimony was, has lost their reinsurance. And the ones that would like to write it and write it to the level that the midwives need, are unable to find the reinsurance that they need to back them up.

Now, why is there so much uncertainty about the function of the midwives when you say—when it is true their experience has been relatively good?

Well, they did indicate that there is a great deal of difficulty in the obstetrics field. This last weekend I was with a doctor that is in family practice. And he has removed from his practice the delivery of babies. And the reason was that his medical malpractice insurance, if he delivered babies, is $30,000 a year. If he didn't, it was $600 a year.

He said it was not worth that difference for him to continue to practice.

Now he is not alone. That is happening in a number of places. And the people that have to make these decisions about risk feel that probably midwives are going to get a great deal more coverage—I mean business, practice. And they will be getting the cases that they cited that the OB's had bad experience in the past.

Now, the statute of limitations under our law won't run until those babies have become citizens. And you are way out. You are looking into the future to a very great extent.

Now eventually I believe that problem will be solved. But it is not an easy one to solve. And so we are in a period where we are adjusting.

One of the most dramatic things that has happened to insurance companies in the last year or so is the fact that they are faced with claims that arise under policies that are very old.

One company had to set up $218 million more in reserves for policies that had expired more than 20 years ago. Those were the asbestos claims and the Dalkon Shield claims. Now that is something that really does cause the industry to stop and think about the future and about the way the law is moving as to liability.

Thank you.

[The prepared statement of Mr. Jones follows:]

STATEMENT OF THE AMERICAN INSURANCE ASSOCIATION

The American Insurance Association (AIA) is a trade association which represents 177 property and casualty insurance companies. The member companies of the Association provide the majority of the liability insurance coverage written throughout the United States. We have been asked to present testimony associated with the sco· of availability and affordability of liability insurance currently being experienced by the purchasers of insurance.

Insurers are exhibiting neither panic nor hysteria by taking a conservative stance on writing certain lines of commercial liability coverage. Rather, they are being prudent in the face of unprecedented losses and a rapidly changing operating environment.

UNDERLYING CAUSES

The liability insurance availability/affordability problem is primarily caused by the structure and operation of the tort liability system rather than a temporary market dislocation. Elements such as causation, latency, identity of defendants, fortuity and size of risk must be examined in order to categorize lines of insurance as insurable or uninsurable.

The most basic concept underlying insurability and insurance contracts is the concept of risk. "Risk" means literally the "chance of loss" or the "probability of loss." If a loss is certain to happen, then there is no risk of loss to transfer, and an insurance transaction cannot take place. There is a growing perception among underwriters that the accumulation of legal remedies provided under state and federal liability systems are changing a hitherto insurable probability of loss to an uninsurable, virtual certainty. Underwriters are attracted to predictability of loss but must avoid inevitability of loss.

The second basic fundamental of underwriting and insurability is that of predictability. If there is no way to forecast the timing or amount of a loss

from past experience, then the loss is unpredictable. Any estimate would be pure speculation.

The risks of loss under general liability insurance are so varied that insurers do not have the well-defined loss experience that is available for lines such as workers' compensation and automobile insurance. Standard coverage for liability insurance originally applied to bodily injury or property damage "caused by accident". The accident concept was also the time trigger of coverage and the building block of limits of liability. An individual policy covered only accidents which occurred during the policy period.

The classical accident, as perceived by insurance underwriters and policy drafters, was concrete, rather than abstract. They regarded an "accident" as a sudden event of a physical nature that happened by chance at a definite time and place and caused rather obvious injury or damage - a collision of vehicles, a scaf[illegible] broke, a roof which collapsed[illegible] Accident" was not a legalistic concept. The underwriters' conception of "accident" harmonized well with both the classical liability principles of tort law and the fundamentals of insurability. Certainty as to time and place laid the foundation for reasonable predictability.

By 1960, it became apparent that coverage based solely on the classical accident concept was no longer adequate for most insureds. There were true "risks of loss" that did not arise out of sudden causes, but were the result of continuous or repeated exposure to physical causes which resulted in nontraumatic, multiple causation, long-latency diseases.

The extent of exposure for liability insurance coverages has changed dramatically. The relationship between low level exposures to useful, but

sometimes harmful substances, and injuries to human beings is not well understood today and is still to a large extent speculative. Tort law a few years ago did not concern itself with speculative possibilities of harm. Doctrines of joint and several enterprise liability had not been formulated. It was not until 1974 that the deluge of asbestos-related claims began.

At the same time that the insurance industry has suffered a drain on surplus and is experiencing a capacity shortfall, the industry is being asked to subsidize the excesses of the civil justice system. Recent court decisions have created new and unpredictable liabilities for property/casualty insurers. Some decisions have gone so far as to rewrite policy terms and create coverage which insurers never intended to provide and for which no premiums were ever collected.

As a business, the industry cannot afford to indefinitely price its product at less than cost. The cost of the civil justice system is rising, therefore the cost to service the nation's liability systems must also rise.

Adverse results have also affected reinsurers and have made that industry extremely uneasy. Not surprisingly, reinsurance is now very difficult to obtain and even when purchased, continued coverage is by no means a certainty. This further reduces the primary insurers' capacity and, as a result, the industry's collective ability to meet every demand for coverage is diminished.

INSURER OPERATING RESULTS

In order to put the present liability insurance problems in perspective, it is necessary to understand the overall financial condition of the insurance industry today. Since 1980, losses and expenses have exceeded premiums primarily because prices failed to keep pace with loss costs and lagged the

nation's overall economic growth. As a result, an unbroken string of underwriting losses began in 1979 and grew at an average annual rate of $3 billion through 1983. An even more dramatic increase took place in 1984 when underwriting losses jumped $8 billion, reaching $21.3 billion. Losses from underwriting for the six years 1979 through 1984 totalled $55 billion. With investment income falling far behind underwriting losses, the industry's pre-tax operating income - the combination of investment income and underwriting results - plunged to a negative $3.8 billion in 1984.

The commercial liability lines experience has been particularly negative. Four key commercial lines - general liability, commercial multi-peril, workers' compensation and commercial automobile - have suffered enormous underwriting losses. General liability leads all lines of insurance with the highest combined ratio of 152.

Diminished surplus and the resulting shortfall in the industry's capacity to respond to the increased demands for insurance will affect the availability and affordability of all liability lines. The Insurance Services Office estimates that, under reasonable assumptions, the capacity shortfall will be $7.2 billion or 5 percent of the market in 1985, $22.6 billion or 14 percent of the market in 1986 and $32 billion or 18 percent in 1987. Ninety-one percent or $56 billion of the 3-year shortfall could be in commercial lines.

VOLUNTARY SOLUTIONS

The American Insurance Association has thus far categorized pollution liability and asbestos abatement contractors' liability as falling into the unmanageable or uninsurable category. In addition, there are a number of availability problems in lines that are badly damaged by the liability system,

but there is still a potential that insurers can provide coverage.* For these problems AIA will work actively with its companies, other trade associations and state insurance commissioners to explore voluntary Market Assistance Programs or other market solutions to the problem. A Market Assistance Program (MAP) establishes a central administrative point where a buyer who is experiencing difficulty in purchasing insurance may come in order to be referred to one or more participating insurers who employ their established underwriting criteria and rating plans. A MAP can also serve to gather information about real or perceived availability problems and be a focal point around which the insurance department, buyers' groups, agents and brokers may discuss availability problems in a constructive manner.

It should be emphasized that merely shifting the burden from one insurance mechanism to another does not address the key problem associated with availability/affordability of liability insurance. Artificial, involuntary insurance mechanisms such as Joint Underwriting Associations mask the underlying problem. The answer to this dilemma has been and remains tort reform. There is a tendency among some regulators and legislators to adopt the expeditious approach of forcing insurers to write insurance coverage, either on an assigned risk or a pooled basis. This solves the immediate availability problem at no apparent cost to the public treasury and with no need to address the difficult task of reforming the tort liability system. However, remedial modifications to the tort system are ignored and unanticipated, retroactive judicial expansion of liability concepts goes unchecked.

*Day Care Centers, Liquor Liability, Directors and Officers, Physicians Malpractice Insurance, Nurse Midwives, Commercial Auto Insurance (Long Haul Trucking Companies and Bus Companies), Rural Homeowners Insurance.

Mr. FLORIO. Mr. Crosby.

STATEMENT OF JOHN CROSBY

Mr. CROSBY. Thank you, Mr. Chairman.

The ABC's of antitrust law, as amended by the McCarran-Ferguson Act where insurers are concerned, do not translate the crisis at hand into a boycott to see. Rather, the availability and affordability crisis offers us an opportunity to bring certainty back to the competitive insurance marketplace and justice to our courts.

For that reason, the National Association of Independent Insurers and its 500-member companies want to thank you for this opportunity.

Mr. Chairman, I am not going to read the balance of my statement because many have talked rhetorically or generally about the civil justice crisis, and the potential for tort reform as a means for solving the availability and affordability crisis on a long-term basis.

Because it has been a long day and we are nearing the end of it, I would like to respond a little bit to some of the statements that have been made, so that we can talk about facts instead of rhetoric or generalizations.

First of all, you have heard a lot about predictability today. You were mentioning this morning the Little League team that had problems getting insurance coverage in New Jersey.

Out in Tulsa there was a case not too long ago where the male center fielder, in chasing a ball, ran into the female right fielder and broker her collar bone, unfortunately. She sued the center fielder and she also sued the team, and the Tulsa Amateur Softball Association for failure to instruct the male center fielder to exercise restraint when playing in coed games.

Now who could have predicted a risk coming out of a mere opportunity to play softball between men and women, as many of the teams do on Capitol Hill?

When you and I were in law school, we learned about the doctrine of sovereign immunity. Well, that no longer exists in most of the States of our land. I would like to cite some statistics, perhaps just from the State of New York. We have heard some information today about the unavailability of insurance coverage for public housing authorities, and local governments, both in New York State and nearby here in Baltimore. In 1983, there were 9,944 lawsuits pending against local governments in the state of New York, claiming $27 billion in damages. Of those, approximately half were against the city of New York City alone. From July 1, 1983 to June 30, 1984, there were 19,000 claims filed against New York City, claiming over $53 billion in damages.

Now if you were an insurance company like Utica Mutual in New York State, would you want to continue writing liability coverage when you're paying out $2 for every $1 you might get back in a premium? That's the reason why we have an availability and affordability crisis in the State of New York and other states, and that's why cities like New York are self-insured.

I would also like to make reference to Mr. Pressman's statement. I do commisserate with the difficulties of being a local public official when having to deal with budgets and with tax rates, and an

insurance availability and affordability crisis. But the things he was asking for, certainty in the appropriations process or a fixed tax rate so that you know what your revenue is going to be this coming year or the next year, are no different in the private sector. We want to know better what premium to charge in order to cover the risk that we have spread throughout the industry.. We want some certainty in what our loss factor is going to be, but with the courts and the juries acting unjustly, we are the whipping boys. We are suing ourselves. Without some predictability in that judicial process, we have no better handle on what the premiums should be or what our losses will be than does Mr. Pressman and the city of Baltimore. We are all trying to get more certainty in our processes.

Congressman Miller this morning was talking about the child care day care crisis in California. I hope you are aware that over the last month, the insurance industry, working with Commissioner Bunner of the State of California, has put together voluntarily, unilaterally, and individually a market assistance plan; 17 insurance companies have entered that market in order to try to provide day care coverage for the State of California.

Now we think we are probably going to need 25 companies in order to do the job, but that's the kind of thing that we can deal with in this crisis situation, acting voluntarily and without some mandate from the Government, in order to correct the problem.

I would say in general, depending on your line of insurance or your type of crisis we have heard today, let the market have some time to correct itself. It is going to be traumatic for budgets, both public and private, but it is coming around. Insurers are going back into governmental immunity or liability coverage, and I am very hopeful that the midwives will get some coverage in the not-too-distant future. It will work itself.

Federal reinsurance is not necessarily going to solve this crisis on a short term or a long term basis.

Mr. FLORIO. What do you anticipate changing such that the day care center situation will change 3 weeks from now, as opposed to now? Or the midwife situation will change? Are you anticipating greater social stability or what is it you anticipate happening that will provide insurance in California 2 weeks from now, as opposed to when it was rejected, or with regard to the midwives, something that's been happening?

Mr. CROSBY. Our basic problem is availability of the insurance product, and what these market assistance plans offer is insurance coverage. It is going to be costing more. I have just returned from the West Coast and talked to many of the officials having to deal with the day care crisis. It's not just California, it is occurring in many states.

What we are talking about for most of these day care centers is a premium increase from $100 a year up to something like $1,000 a year. Granted, that is almost a 1,000 percent increase, but if you have 10 children in the day care center, we are talking about perhaps asking each parent or parents to increase the fee $100 in order for that day care center to be able to afford that coverage. It's working itself out. There's nothing that's going to happen in the court system in 2 weeks, or the type of policy being offered to those day care centers.

We are getting insurers back to the table who are willing to sell their insurance product, and that's the important thing. It may cost more, but it will work itself out.

I would also like to respond, if I might, just briefly to Mr. Hunter and Mr. Nader. While some of these actions being taken by the private sector speak for themselves, I would like to tell you what these actions do not constitute.

This is not a manufactured crisis. Raising rates and canceling coverage merely reflects an exercise of independent sound business judgment as protected by the Colgate doctrine in a U.S. Supreme Court ruling.

This is not part of an illegal effort to rewrite policies or force changes in the legal system. To state otherwise would put the cart before the horse.

This is not a concerted refusal to deal with municipalities, doctors, manufacturers or day care centers. As I have told you, the insurance industry is cooperating with State regulators, not conspiring with them, to develop open lines, market assistance plans, joint underwriting associations and risk pools, to name a few of the voluntary and unilateral actions being taken to address the crisis.

Nor, in our opinion, is it time to make a deal with the banks for underwriting powers, to make a deal with the Federal Government for reinsurance coverage, or to unfairly tax our industry.

In sum, the availability problem in our opinion is an economic problem and a legal problem that will be solved over time so that the best of years can return to the insurance company and our insured properties.

[The prepared statement of Mr. Crosby follows:]

Remarks

of

John B. Crosby, Esq.

Vice President and General Counsel

National Association of Independent Insurers

The ABC's of antitrust law, as amended by the McCarran-Ferguson Act where insurers are concerned, do not translate the crisis at hand into a boycott to see. Rather the availability and affordability crisis offers us an opportunity to bring certainty back to the competitive insurance marketplace and justice to our courts. For this opportunity today to state our piece, the National Association of Independent Insurers and its 500 member companies simply want to say thanks.

1984 and 1985, like the Tale of Two Cities by Charles Dickens, represents the best of times and the worst of times for the insurance industry. Last year's operating results were the worst ever, and while 1985 may not be the best, it is a critical year indeed. Insurers must regain control of their basic business. Action must be taken during 1985 to insure a return to profitability in insurance operations. That action on the part of over 3,000 property and casualty insurance companies in the United States - taken individually, not in concert - is the cause of the availability and affordability crisis at issue today.

But what is the cause of the cause, the egg before the chicken, the horse before the cart? Part of the problem is inadequate pricing of policies in avery competitive marketplace. It is also the result of social inflation, or court interpretations which have gone beyond anticipated benefits, and rapidly increasing defense costs.

A basic insurance principle is that what has happened in the past, will likely happen in the future. It is this sense of stability which permits insurers to price their products. But the courts have erased this principle with interpretations which have abandoned the concept of tort liability. This is particularly in evidence in the commercial lines which deal with product liability, pollution liability, medical liability, and municipal liability.

As litigation frequency and court awards have increased, so has the cost of defense. As the costs of court defense are not included within the liability policy limits, the insured has no financial stake and as a result, no incentive to help restrict defense counsel to only those activities and expenditures which are likely to be productive.

In order to continue to provide the insurance protection necessary for a growing economy, the companies must return to a position of solvency and this can only be accomplished through price increases. In the short run this willbe traumatic on the budgets of buyers, public and private. To do otherwise raises the prospect of driving a large segment of the industry into insolvency and forcing many buyers of insurance to go bare. As Forbes magazine put it not too long ago, "a World without insurance" would result.

In order to keep price increases within some degree of reason, the loss side of the equation must be dealt with. But court awards will change only

when forced to do so by public pressure. In a number of states business coalitions have been formed to review the trends which have developed over the past decade and to recommend legislative remedies. The insurance industry, along with business and labor, have commissioned a study by the Rand Corporation to analyze the present tort system, but their recommendations have not materialized to date.

The Insurance Services Office is proposing several changes which could have long-range benefits to the buyer. One is to give insurers (and their buyers) the option of using a "claims made" policy. This option will permit insurers to put a more realistic price on the commercial liability product as it will eliminate the uncertainty brought about by claims discovered today that are due to occurrences which happened years ago.

ISO is also proposing to limit defense costs by including this benefit within the policy limits. This, of course, would permit the insurer to place a limit on the total loss costs. This proposal has not been accepted by many companies and there is a running debate on the subject at this time. It isincluded here as an example of things being proposed by the industry to try to get a rein on costs.

Those are some of the actions being taken by the insurance industry. Now let me tell what those actions are not.

This is not a manufactured crisis. Raising rates and cancelling coverages merely reflects an exercise of independent sound business judgment protected by the Colgate Doctrine, See U.S. v. Colgate Company, 250 U.S. 300 (1919).

This is not part of an illegal effort to rewrite policies or force changes in the legal system. To state otherwise would put the cart before the horse.

This is not a concerted refusal to deal with municipalities, doctors, manufacturers, or day care centers. The insurance industry is cooperatingwith state regulators, not conspiring with them, to develop open lines, market assistance plans, joint underwriting associations, and risk pools to name a few of the voluntary and unilateral actions being taken to address the crisis.

Nor is this a time to make a deal with the banks for underwriting power, to make a deal with the Federal government for reinsurance, or to unfairly tax.

In sum, the availability problem is an economic problem and a legal problem that will be solved over time so that the best of years can return again.

Mr. FLORIO. Thank you very much.
Ms. Walters.

STATEMENT OF MAVIS A. WALTERS

Ms. WALTERS. Thank you, Mr. Chairman.

I am Mavis Walters, senior vice president of Insurance Services Office, Inc. I am a fellow of the Casualty Actuarial Society and a member of the American Academy of Actuaries.

ISO is a nonprofit corporation that makes available rating, statistical, actuarial, policy form and related services to any U.S. property/casualty insurer. We have no membership requirements, nor do we have any adherence requirements with respect to advisory rates, loss costs, policy forms, or programs.

The problems that we have been hearing about this long day really can't be understood properly until we appreciate fully the current financial condition of the property casualty insurance industry.

In 1984, our industry experienced its worst year ever. It's not something we are proud of, but it's something we must recognize. We have prepared some charts that I hope will make clear some aspects of the situation which got really muddled through this morning's discussion.

If you would refer to the red line in that chart, that refers to our underwriting losses. Since 1979, those underwriting losses totaled $55 billion; $21.3 billion in 1984 alone. The combined ratio, which is the way of looking at these figures—in fact, the combined ratio is really a measure of the industry's or an insurer's success in their underlying business.

That ratio reached 118 in 1984 for all lines of business combined.

What does that mean? It means, very simply, that $118 were required for losses and expenses incurred for every $100 of premium earned.

Now, although the underwriting results, as you can see from that chart, clearly from 1979 have grown continuously, the losses have grown, and therefore the line goes down—I'm sorry, the underwriting has also declined since 1979, therefore the line goes down, but investment income has grown continuously, and that is the blue line which rises.

However, when you look at the two combined, the average annual investment income growth of $1.7 billion did not even come close to the average growth in underwriting losses of $3 billion.

In 1984, although investment income was still growing at a healthy rate by 10 percent, underwriting losses grew by 60 percent, which produced a pretax operating loss of $3.8 billion.

I'm going to explain what that is. If you go to the next chart, you can see.

The next chart really combines those two lines, underwriting and investments, and that is a definition, in fact, of pretax operating income.

In 1984, it was a loss of $3.8 billion. Again, we have to emphasize there are no hidden sources of income here, no hidden pockets. This is all of the underwriting income which in this case was a loss, after all of the investment income.

Now the sum of these two quantities represents the bulk, the major portion of income that can accrue to an insurance company. It's not the total piece, though. There are other items that can be considered, and particularly when we compare insurance firms with other firms, we tend to look at an income measure, that is your total income, after realized capital gains, after tax.

Mr. FLORIO. Where do the reserves that we heard so much about before, where do they come into this calculation?

Ms. WALTERS. The reserves are a measure of the liabilities that an insurer owes to claimants, and they are a part of the underwriting results primarily, but the income that is earned on assets equivalent to those reserves is measured in the investment income line.

Mr. FLORIO. So that means that the underwriting results you are calculating, paying out money, that you are actually holding——

Ms. WALTERS. Exactly. But on the income side, we are including in this measure of pretax operating income, we are including in that all of the investment income we are earning on that money before we pay it out. So we are including those pieces.

Mr. FLORIO. Just to get the clarification. Someone who was not sophisticated on the underwriting side would say, well, you're saying you're paying out underwriting moneys, but *x* percentage of that amount is really not moneys that you have paid out.

Ms. WALTERS. That is correct. In fact, I never use the term "paying out," because it is not correct; but that is correct, they might say so. That's why I think it is important to look at the total picture.

If we just spoke of underwriting losses, I think we could legitimately be criticized, because you are not considering the other side of the coin. You are holding that money, and you are going to pay it out, but while you are holding it, you are earning something on it. That's why we have included those figures.

Mr. LENT. You put that money, the earnings on reserves, as part of the investment income.

Ms. WALTERS. Investment income, that's correct, Mr. Lent, and when you combine the two, this is the picture that you get. Pretax operating income, as you can see, was a loss.

Mr. LENT. While we are on that, is it customary in the industry for a company to put more in reserve than it has to put in reserve, according to the laws of the State or locality?

Ms. WALTERS. No, Mr. Lent, it is not.

Mr. LENT. An insinuation was made that you were stashing all the profits in the reserves.

Ms. WALTERS. I heard a lot of things this morning that I hope we get a chance to rebut.

Historically it is well documented, and even today it is well accepted by industry analysts that is people outside the insurance industry, stock analysts and knowledgeable insurance people and observers, that this industry continues to be underreserved and perhaps seriously underreserved.

There is no evidence, and there hasn't been in my—ever since my professional career began. All of the evidence that has ever been gathered points to underreserving for these ultimate claims, not overreserving. That pattern continues today.

Let me go on, because there was talk this morning, too, about, well, operating income. And I heard some talk, well, insurers overall did make money. That's true on a net-income basis, and that's the other measure.

This is the bulk of the income: Pretax operating income. You can think of the pretax operating income, if you will, as cash-flow. You've got money coming in from premiums and investments, and then your money going out. You can see the cash-flow has been negative, but there are other sources of income, like tax credits, realized capital gains, and new capital, to the extent you can get it, either from outside sources or, if you are an insurance company owned by a noninsurance parent. And when you consider those, all of those items, you get to total income, and the correct measure of whether or not you have been successful or the measure of the success on a total income basis is the standard of return on net worth, which I think you recognize is a term that is referred to, to measure the profitability of other industries as well.

Well, on this total income basis, the industrywide rate of return for the property casualty insurers in 1984 was in fact 1.7 percent, not 3 percent as stated earlier, but 1.7 percent. And, in fact, 50 of the top 100 insurer groups in the United States actually had a negative return on net worth in 1984.

Mr. FLORIO. Your response to the questions that were raised earlier about the sales price of the stock in the companies is what?

Ms. WALTERS. Manifold. First of all, I think you gentlemen certainly would all recognize that the stock price rises are a reflection of investor expectations, have nothing to do with past profits, but they reflect investor expectations.

The second point is——

Mr. FLORIO. Clarification of that? Your advanced situation, you say, is getting worse?

Ms. WALTERS. No, no, I am not saying it's getting worse. I haven't finished my testimony. I am going to talk about there are some types of improvement. But by no means are we at a position where this can be considered a profitable industry.

Institutional investors primarily are those who invest in insurance companies and stock insurance companies, and they are some of the most astute and intelligent investors. They could see the signs as they emerged in the last quarter of 1984, signs began to emerge that this industry was finally getting ahold of its financial condition, a recognition this disastrous competition had to come to an end. And there was a firming of prices beginning in the last quarter of 1984, and it has continued for the first half of 1985.

Because this industry also has figures that are published in all sources that can be analyzed by those who chose to look at them, those signs first started appearing, and that's when the institutional investors and others said, uh-huh, finally after 7 years of successive decline, it looks like they are about to turn the corner.

Of course, smart knowledgeable investors get in at the bottom of the cycle so they can ride it to the top. That's what has happened. I've got a lot more quotes that are not just my opinion, but the opinion of the knowledgeable experts. Let me just read one, because this is an issue which comes up all the time.

We have heard that the stock prices for insurers have risen double the amount for noninsurance firms. And that's true, they have risen at that rate, but it makes it sound like it's a massive increase.

In the first half of 1985, property casualty stocks on this one index, which is a good index, Best index, have advanced 30 percent. Investor excitement being generated by a reasonable consensus that the longest industry down cycle in history has finally turned, albeit by a small margin. They were rewarded, on average, by advances twice the size as those reached by the general stock market.

So, yes, it got twice the size, but a 30-percent rise.

I also should add this was on half-year figures. Since reaching its all-time high 6 weeks ago, that is by the end of the first half, the multilines index for the insurance we are talking about is down 10.8 percent, more than double the decline of any of the other component indices of the same period. That's the story on the stock market. We can come back to that if you have more questions later. I would like to try and finish a few points. These are points I think will help clarify some of the things that came up this morning.

This figure is the return on yearend net worth. As you can see, insurers still trail the Fortune 500 by 11 percentage points.

Well, the end result of the dismal financial conditions in 1984 was a decline of nearly $2 billion industrywide, in a figure that is technically called policyholders' surplus. It is equivalent to the capital and surplus of other noninsurance concerns, or net worth. It actually declined on industrywide basis in 1984.

Now that figure, policyholder surplus, really is a measure of an insurer's ability to provide insurance safely, since it represents essentially uncommitted funds, which stand behind every insurance policy. It is the financial guarantee which permits insurers to get into this risky business.

Under the current financial conditions, insurers' ability to provide the needed insurance is limited. In fact, in early 1985 our organization, ISO, did a study called "The Coming Capacity Shortage," and, Mr. Hunter was right, at the time we did it we estimated available property casualty insurance may fall short of demand by as much as $62 billion over the next 3 years.

Now, there have been some highly unusual developments since that study was completed, which indicate that the magnitude and severity of the shortfall may be somewhat less than originally indicated, but nevertheless our conclusions remain substantially the same. And that is, very simply, that the laws of supply and demand work in this industry as they do elsewhere. The current demand for insurance exceeds the available supply because the current financial condition of the industry is not as sound as we would like it to be.

One point that is important to emphasize is that this current property-casualty-underwriting cycle is dramatically different from any cycle that this industry has experienced in the past. This is another confusion that has resulted from some discussions earlier. Because it is not a typical cycle, unusual and very severe problems are emerging, and the solutions to these problems are not easy or readily apparent.

I would like to explain briefly why this current cycle is so different. And it goes beyond the obvious one, a question of timing.

If we could go back to the first chart, please, and let's see if we can't show you——

When we talk about a cycle, the cycle is an underwriting cycle. So, I ask you to just pay attention to the red line.

And you can see, for those mathematically inclined in the audience, the curve looks like a sine curve. No matter, it is a curve that you can see begins 1968 to 1972, 1973, 1974. It circles up and down. But you can see in about 1978–79, the line extends for quite some period of time downward.

So, there is an obvious difference. In this cycle, it is much more prolonged and much more serious than preceding cycles. That is an obvious difference. There are other reasons why this is more serious.

The decline in surplus that I referred to earlier for 1984 was caused by operating losses. That figure, remember that I said represents the bulk of insurers operations. All investment income, and all underwriting. That is what caused the decline in surplus.

In previous cycles when we have had declines in surplus, they were brought about by a slump in the stock market; something beyond our control, and something in fact which recovers when the stockmarket recovers. That wasn't true about the last cycle.

Second reason: The 1984 results were unique in their variation across product lines, particularly I'm talking about personal lines versus commercial lines. And we heard some discussion about that.

In previous cycles it was the personal lines results which were worse than commercial lines. Now it is the reverse. The reason it is important is because personal lines, homeowners and personal auto insurance, they are what we call class-rated business, and they have what we in insurance call a short tail. That is the claims come in very quickly. Because of those two factors, personal lines results can improve very quickly and rather easily. It doesn't take very long.

Now that commercial lines are the source of the problem, it is going to take a lot longer to recover, because it takes a lot longer to get prices back to where they need to be, and you have got the long tail of liability.

The third reason why this is a much difference cycle is that reinsurers had much more adverse results than the industry as a whole; at least a 10-point difference in 1984. In previous cycles the reinsurers and the industry in total had just about similar results. Now, reinsurers are worse.

Well, what does that mean? It means that in previous cycles on the road to recovery when reinsurers weren't suffering even worse than the direct market, they provided almost a safety valve, a means of introducing more capacity as we would call it, into the industry. But now that they are suffering, in fact worse than the direct market, they have tightened their underwriting standards as reasonably prudent people will do.

Well, these differences, coupled with the severe underwriting losses will make recovery markedly different and longer than in recent cycles.

Unfortunately, the 1985 results so far continue the past pattern. Operating results, the sum of again, underwriting and investment income, continue in the red—over $2 billion of operating losses for the first half of 1985.

But, there is some good news. These other items, like new funds, tax credits, and a record stockmarket rise overall, have produced enormous amounts of realized capital gains by historic standards. That has had a positive effect and a positive influence.

Without those highly unusual elements that I just mentioned, if they all hadn't coalesced together, surplus would have declined even further.

Two other important areas of consideration—I will try to be very brief here—which aren't cyclical in nature, but I think are incredibly important to understand what is going on and to understand why insurers' confidence in their ability to price the product accurately, that confidence has been seriously eroded, involves the elements that you have heard a lot of discussion on today: Court interpretation of insurance policy language, and consumer or claimant expectations. These items aren't cyclical. We haven't found that court interpretations of policy language becomes more restrictive, and then later on becomes more liberal and innovative. Rather, the consistent trend has been to ever-more expansive interpretations with the results being a finding of coverage, regardless of policy language.

That, gentlemen, is not cyclical, but it is going up.

Similarly, we have not observed any reluctance on the part of those who are injured to sue someone or something for damages. On the contrary, all available evidence indicates that ever-increasing expectations within our society—there are ever-increasing expectations that whenever someone is injured for whatever reason, someone else must pay and pay dearly.

There seems to be an ethic evolving in our society today which completely absolves individuals for any responsibility for their own conduct. I think that may be part of the problem. Some people may smoke to excess, drink to excess, do whatever, but you will find someone else to sue for your own conduct.

There also seems to be today no acknowledgement any more that something that we used to know not many years ago as an accident, can happen. There is no such thing as an accident. Every time there is something which creates a bad result, someone is going to get sued.

While we believe that the current insurance availability and affordability problems are in large measure an outcome of the present civil justice system in the United States, insurers have not been sitting idly by doing nothing. Rather, we have been working diligently over the past several years to do something that is within our control, and that is, we have developed a new, modernized, simplified, commercial general liability policy form which we believe will respond to current marketplace needs. This new program will offer a choice between two attractive versions of a commercial general liability policy form.

One, the occurrence form will provide coverage for bodily injury and property damage that occurs during the policy period.

The other, the claims-made version, will provide coverage if the claim is first made during the policy period.

The only difference between these two versions are in the provision related to what triggers coverage. We expect that the availability of a claims-made policy will increase availability of insurance in those instances where occurrence coverage simply cannot be underwritten or priced accurately with any degree of confidence. We believe this new product will allow insurers to price their products with a little greater assurance and confidence.

To the insured who presents a difficult exposure either because of his own or her own particular circumstances, or because of the business in which they are engaged, the availability of a claims-made contract may mean the difference between getting insurance, or having no insurance at all.

We do not suggest that the new CGL program panel will solve all the insurance availability or affordability problems of today's marketplace. But we are confident that it will be seen as a positive step which has been taken by this industry in these difficult times.

[Testimony resumes on p. 244.]

[The prepared statement of Ms. Walters follows:]

STATEMENT OF

MAVIS A. WALTERS

SENIOR VICE PRESIDENT

INSURANCE SERVICES OFFICE, INC.

I am Mavis A. Walters, Senior Vice President of Insurance Services Office, Inc. I am a Fellow of the Casualty Actuarial Society and a member of the American Academy of Actuaries.

Insurance Services Office, Inc. (ISO) is a non-profit corporation that makes available rating, statistical, actuarial, policy form and related services to any U.S. property/casualty insurer. ISO is not a trade association and therefore does not routinely represent insurers in legislative forums. However, on occasion, we do serve as technical advisors to the property/casualty insurance industry and in that capacity may appear with trade association representatives before legislative bodies.

ISO has no mandatory membership requirements, nor do we have adherence requirements with respect to advisory rates, loss costs, policy forms or programs. In fact, we actively encourage independent action by participating insurance companies.

We serve participating insurers by gathering, storing, and disseminating statistical information to regulators, as required by law, and to insurers for their own use. We also develop and assist in implementing programs that help define and cover risk. We promulgate advisory rates or advisory prospective loss costs for sixteen lines of insurance including personal lines (automobile and homeowners) and commercial lines of insurance such as Commercial General Liability (CGL).

In order to put the present insurance availability and affordability problems into perspective, it is necessary to understand the overall financial condition of the insurance industry today. Since 1979, losses and

expenses have exceeded premiums primarily because prices failed to keep pace with loss costs and lagged the nation's overall economic growth. As a result, an unbroken string of underwriting losses began in 1979 and grew at an average annual rate of $3 billion through 1983.

An even more dramatic increase took place in 1984 when underwriting losses jumped $8 billion, reaching $21.3 billion. Losses from underwriting for the six years 1979 through 1984 totalled a staggering $55 billion.

The poor overall results of the property/casualty insurance industry in 1984 were not felt uniformly in all areas of operations. The combined ratio, also called the trade ratio, is a useful tool to analyze the relative underwriting results of different segments of the industry. This combined ratio is the ratio of incurred losses, loss adjustment expenses, and policyholder dividends to earned premiums, plus the ratio of underwriting expenses to written premiums.

The combined ratios for all lines of business, countrywide, have exceeded 100 in each of the most recent six years. This means simply that losses and expenses have exceeded the premium collected for those years. Most alarming is that between 1983 and 1984, the growth of the combined ratios was the largest since 1973-1974. However, while the 1973 ratio was 99 and rose to 105 in 1974, the 1983 combined ratio already stood at the ominous level of 112 before leaping to an unprecedented 118 in 1984.

This deterioration in results has been led by the commercial lines. Historically, personal and commercial lines results have closely paralleled each other. Between 1967 and 1982, the difference between the combined ratios never exceeded 6 points. As recently as 1981, the ratios were only 2 points apart.

Then in 1983, the gap grew to 12.5 points. In 1984, it expanded to over 20 points. These high ratios are of even greater corcern than they would otherwise be because industry analysts agree that the commercial lines combined ratio is understated due to reserve inadequacy. Since many companies wr‑.e mostly commercial lines business, the combined ratios for these insurers are much worse than they are for the industry as a whole.

The four key commerical lines of business experienced disastrous results in 1984. Medical Malpractice at 170, had the highest combined ratio. General Liability had the next highest at 152; Commerical Multi-Peril was 135; Workers Compensation stood at 122 and Commerical Auto Liability experienced a 144 combined ratio. Results for the first half of 1985 are not appreciably better. Medical Malpractice is at 169 and Commerical Auto Liability is still in the 140's at 142. G.L. is at 145.

Another segment of the industry which has been particularly hard hit has been the reinsurers. This is due in part to their heavy concentration in the commercial lines, but is due also to their particular susceptibility to very large losses and unusually adverse loss experience. For the past two decades, reinsurer results have closely paralleled those of the property/casualty industry as a whole. The gap between the combined ratios never exceeded 4 1/2 points, except for the 6-point gap in 1965, the year of Hurricane Betsy. As recently as 1982, the two combined ratios were only 1/10 of a point apart. The gap grew to 6 points in 1983 and then to 10 points in 1984.

While underwriting results h   d since 1979, the industry's net investment income has grown co   y. In an attempt to generate cash flow for investment, insurers con.. ed aggressively for premium dollars,

knocking prices more and more out of line with loss costs. However, the average annual investment income growth of $1.7 billion did not even come close to the average annual growth of $3 billion for underwriting losses from 1979 through 1983.

In 1984, the 10% increase in investment income of $1.6 billion was far below the 60% increase of $8 billion in underwriting losses. With investment income lagging far behind underwriting losses, the industry's pretax operating income - the combination of investment income and underwriting results - plunged to a negative $3.8 billion in 1984. This figure, pre-tax operating income, is the primary component of insurer income and represents the pre-tax profits from insurance operations. It is this component of income which is responsible for the long term viability of the industry. The huge $3.8 billion loss in 1984 is the largest ever experienced in this industry. Although investment income has been rising gradually over the last several years, it is no longer able to offset the staggering underwriting losses which increased 60% in 1984 alone. Clearly, if the property-casualty insurance industry is to maintain its current capital base, let alone attract new capital to meet the insurance needs of a growing economy, the industry must improve its earnings. (See chart A attached)

A second measure of insurer profitability is the total rate of return on net worth. This measure includes operating income, realized capital gains, taxes and other miscellaneous income, and is often used to compare the profitability of insurance with other industries.

By this measure also profits in the insurance business declined in 1984 for the seventh consecutive year. The industrywide average rate of return on year-end adjusted statutory net worth (excluding unrealized capital gains) was only 1.7% in 1984.

Only record realized capital gains of $3 billion and tax credits of nearly $2 billion prevented net income after taxes from dipping into the red. Negative cash flow and tax considerations in 1984 made realization of long-term capital gains attractive if not necessary. But tax credits are rapidly disappearing, and capital gains of this magnitude cannot be relied on, particularly in light of the over $3 billion unrealized loss in 1984. Even with these accounting aids, 50 of the top 100 insurer groups' return on net worth was actually negative. Falling profits were experienced across virtually all segments of the industry.

During the period 1960 through 1984, insurers typically earned less than the average rate of return achieved by other industries in the United States. The annual rate of return on net worth for insurers has exceeded the Fortune 500 all-industry average in only five of the past eighteen years. In 1984, insurers' rate of return trailed that of the Fortune 500 by more than 11 percentage points. This is another indication of the rather fragile financial condition of U.S. insurers. (See chart B attached)

Yet another ingredient adding to the poor financial condition of the insurance industry is the decline in policyholders' surplus. Policyholders' surplus is the difference between insurers' assets and liabilities and is a measure of an insurer's capacity to provide insurance coverage safely. This is the financial security, the uncommitted funds of an insurer that stand behind every insurance policy. It is this quantity that provides the necessary cushion to support the shock of major catastrophes, stock market declines and loss reserve inadequacies. As a result of operating losses in 1984, industry surplus fell 3% to $63.6 billion. In constant dollars, 1984 surplus was 3% below the 1980 level, which indicates that capacity may not be sufficient to meet the insurance needs of an expanding U.S. economy.

The 1984 drop in surplus would have been much worse were it not for the record-breaking influx of new funds into the industry. New funds represent additions to the capital structure of an insurance company. The two major sources of these funds are new stock offerings and contributions from non-insurance parents to insurance subsidiaries. Reasons for an addition to capital range from preventing an insolvency to expanding underwriting capacity.

Prior to 1984, new funds invested annually in the industry never exceeded $1.5 billion, averaging $1 billion over the last decade. However, in 1984, capital additions soared to a record high of over $3 billion. If 1984 new funds had been near average, the surplus decline would have been over twice as large as the $2 billion recorded.

Other action taken by the industry to preserve scarce surplus was a dramatic cut--21 per cent--in stockholder dividends from $2.9 billion in 1983 to $2.3 billion in 1984. In addition, the industry benefited from a record federal income tax credit of $1.7 billion. These measures added an unexpected $3 billion to the industry surplus in 1984 thereby reducing the overall decline from almost $5 billion that had been estimated earlier to about $2 billion.

This decline in surplus has raised concerns about the solvency of many insurers. In 1984, at least 22 property/casualty insurance companies were found to be financially impaired. Most of these companies were insolvent. Additionally, several sizable insurers were placed in rehabilitation by regulators with an indication given that liquidation could not be avoided. In total for 1984, 418 property-casualty companies, representing 17% of the total number of companies filing annual statements were targeted for attention by insurance department officals.

A.M. Best Company annually conducts a specialized financial analysis of most United States insurance companies and expresses its evaluation in the form of a rating. All companies rated "Excellent" are considered to be outstanding and have no material unfavorable variances from A.M. Best's averages. Lower ratings reflect increasingly unfavorable variances from A.M. Best's industry standards. An "Excellent" rating is considered essential if an insurer wishes to do business with top U.S. corporations, municipalities and government contractors.

From 1982 to 1983, 30 companies' ratings were upgraded to "Excellent" while 78 companies' ratings were downgraded from "Excellent". In 1984, there were 38 increases to "Excellent", but 150 companies received rating decreases from this level. Because 1984 operations caused a sudden and dramatic decline in the financial condition of many top-rated insurers, further decreases are expected in 1985 as ratings are developed from 1984 financial statements.

The declining solidity of the P/C industry is also illustrated by what is termed the exposure ratio, defined as the ratio of net written premiums to surplus. The percent of industry premiums written by companies with high exposure ratios has increased dramatically. The National Association of Insurance Commissioners (NAIC) has selected a premium-to-surplus ratio of 3-to-1 as a maximum. Any insurer writing above this level fails the premium-to-surplus test. The percent of industry premiums written by companies whose premium-to-surplus ratio exceeds 3-to-1 has tripled since 1981, to almost 15%.

In early 1985 ISO released a study entitled, "The Coming Capacity Shortage," which projected that the available property/casualty insurance may fall short of demand by $62 billion over the next three years. This projection was based

on a fairly stable financial scenario which indicated that the capacity shortfall could be even more severe if circumstances are less favorable than assumed.

The model used for the ISO study was based on actual results for the first three quarters of 1984 from which an estimate of 1984 results was made. However, some highly unusual developments since that study was completed indicate that the magnitude and severity of the current shortfall may be somewhat less than our analysis originally indicated. Nevertheless, we still are confident that the conclusion remains substantially the same, i.e., the demand for insurance exceeds the current available supply.

Aggressive and proper pricing actions now being taken will ultimately reverse the six-year deterioration in property-casualty returns on net worth. But these actions are bringing on new industry problems, which is part of the reason why we are here today.

Unfortunately, the first half of 1985 continues the unhealthy past pattern in many ways. The bad news is that operating income, as we had predicted, is still negative, by over $2 billion. On the other hand, the good news is that the industry continued to benefit from new funds, tax credits, and a record stock market producing an enormous amount of realized capital gains by historic standards. Without these unusually high contributions, surplus would have declined still further. Instead, the surplus growth of about $5 billion has enabled the industry premium to surplus ratio to remain at about 1.9 to 1, even with a healthy written premium growth of more than 17% for the first half of 1985.

If an insurer could estimate its costs accurately and pass these costs on to an insured in the form of premium increases, there would be no reason to deny coverage for any risk, within the bounds of the insurer's capacity to write insurance. But the fact is that the expansive tort liability system has created tremendous uncertainty in the ultimate costs of a liability contract. It is the near impossibility of determining actuarially sound prices in such a legal environment that has stopped insurers from insuring certain risks.

Consider some of the legal developments which have contributed to the disastrous underwriting results of 1984. In the area of Pollution Liability, insurers are being required to defend and indemnify commerical insureds for hidden or gradual pollution of the environment despite having explicitly excluded coverage for all but "sudden and accidental" losses. The use of medical presumption has been expanded to find liability when there has been no clearly established link between exposure and injury or damage. And strict,joint and several liability has been imposed on users of hazardous waste dump sites, not only for future insureds, but retroactively to apply to all past insureds.

In the area of Medical Liability, malpractice is increasingly being found whenever there is a bad medical result. There has been a radical expansion of government tort liability in the last 10 years, affecting Municipal Liability. And in the area of Products Liability, there has been a literal explosion of cases resulting from liability awards on products which

- were built and sold decades before the injury
- had "State of the Art" safety features and technology at the time they were manufactured
- had safety devices tampered with or removed

- were not used for their intended purpose
- were accompanied by warning labels and safety instructions
- were not proven to be harmful, and
- were not even proven to be made by the defendant.

Given the uncertainties involved in trying to anticipate the legal environment even a few years hence has made reasonable actuarial pricing all but impossible for some risks. The expansive interpretations affecting any area of tort liability are likely to find application in other areas as well, making even the so-called profitable risks of a few years ago potentially uninsurable.

In recognition of the enormous problems facing insurers and policyholders alike, ISO and its participating companies have been working diligently our the past several years to develop a new simplified, modernized commerical general liability policy form to respond to current marketplace needs. The new Commercial General Liability Policy is the first major revision for this line of insurance since 1966.

This policy form is the result of years of effort and the most extensive industry review of a new policy form in ISO's history. ISO distributed more than 1,500 copies of an exposure draft to a broad cross-section of industry interests-nearly 250 groups and individuals in all-for their review and comment. Insurers, producers, buyers, reinsurers, educators, lawyers, risk managers, adjustors, consumers and trade associations all provided advice, and more than 30 organizations reported the suggestions and reactions of their members.

Of course, not every suggestion could be adopted, because some were diametrically opposed to one another. But ISO considered every single suggestion, and the policy we are introducing reflects many changes-big and small-made as a result of the industrywide review.

The new CGL Program offers a choice between two attractive alternative versions of a Commerical General Liability Policy form.

One version, the "occurrence" version, provides coverage for bodily injury and property damage that occurs during the policy period. The other version, the "claims-made" version, provides coverage if the claim for damages because of bodily injury or property damage is first made during the policy period. The only differences between the two versions of the policy form are in the provisions related to what activates or triggers coverage.

The "occurrence" trigger is provided in recognition of continued marketplace demand for a modern "occurrence" form. The "occurrence of injury or damage" language that triggers coverage in the new policy is essentially unchanged from the coverage trigger in the policy it replaces.

The claims-made language for triggering coverage is a brand new alternative. The "claims-made" policy's unique features that assure reliability of coverage make it unlike any other claims-made policy now in use. The introduction of this "claims-made" trigger -- and the continued availability of an "occurrence" trigger, too -- calls for informed judgment and a rational assessment of the alternatives by insurers, producers and ultimately, by consumers.

The need for these changes can be summarized as follows.

1. Litigation relating to the existing "occurrence" policy has been costly and time-consuming. For the most part such litigation - which continues to go on to the detriment of insurers and policyholders - has centered on latent bodily injury and long-term exposure issues involving substances such as asbestos and DES. A key issue in dispute is: When did the injury or damage occur? That's extremely important in the context of insurance because the answer determines which "occurrence" policy or policies apply. Litigation

over that question is likely to affect more and more insureds of all sizes in all types of business, as new cases arise where the time when bodily injury or property damage occurred is at issue.

2. Many insureds have to rely on policy limits provided by old "occurrence" policies to respond to current claims, because the injury or damage may have occurred long before the claim is made. Those old policies may have been purchased many, many years before claims emerge, settlements are reached and judgements rendered -- and years before inflation eroded the value of the old policies' limits.

3. Some courts have adopted legal theories in latent-injury or long-term exposure cases, which hold that injury occurred during a long series of "occurrence" policies. That leaves many contracts- and sometimes many insurers-with primary defense and indemnity obligations for a single claim. Often, such situations arise when there are many claims for similar or related injury. As a result, insurers don't know how much is at stake, and for how long, under these contracts. That makes it difficult to determine accurate premiums and loss reserves. And beyond that, such "stacking" of limits poses a serious threat to the very solvency of some insurers. In view of this, some insurers and reinsurers have become increasingly reluctant to handle "occurrence" coverage. Without some change, there could be a real insurance-availability problem.

4. Under the existing policy form, the only imit that applies to some parts of the coverage is a per-occurrence limit, so the insurer's liability for injury that occurs during the policy period increases with the number of "occurrences" held to have produced the injury. That liability could be astronomical, depending on how courts interpret the term "occurrence." Stacking per-occurrence limits within a single policy further threatens insurance availability and insurer solvency. (The existing policy form does, however, put aggregate limits on many parts of the coverage, including products and completed operations.)

5. Some courts-after long and costly lawsuits-have interpreted the "sudden and accidental" exception in the existing policy form's pollution exclusion so broadly that insurers and reinsurers are exposed to unknown but potentially gigantic losses totally unforeseen when existing policies were written or priced. Moreover, pollution coverage is particularly vulnerable to all the "occurrence" issues arising under the existing policy form. Because pollution-related damage or injury is often latent there can be many causes of the injury, and there may be no aggregate limits on the coverage.

6. Need exists to consolidate and modernize ISO's advisory commerical general liability policy forms. Today many forms are needed to provide the scope of coverage that most buyers consider standard.

7. To improve efficiency and reduce costs, the existing policy forms, manual rules and rating procedures need to be streamlined and made more adaptable to automated policywriting.

8. Insurance buyers and regulators want more readable and understandable insurance contracts for all lines of insurance.

We expect that the availability of a claims-made policy will increase availability of insurance in those instances where occurrence coverage simply cannot be underwritten or priced accurately, and will allow insurers to price their products more accurately.

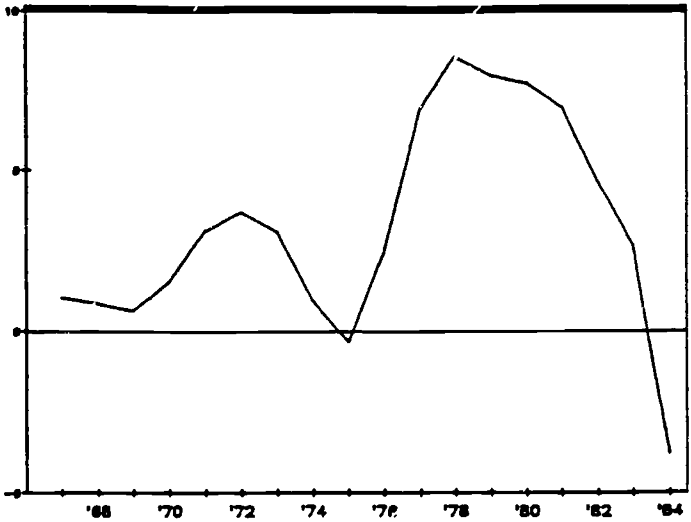
To the insured who presents a difficult exposure, either because of his own particular circumstances or the business in which he is engaged, the availability of a claims-made contract may mean the difference between getting insurance or having no insurance at all. Even for a typical, non-problem risk, the claims-made option can mean significant premium reductions and offer the insured the ability to keep his limits of liability insurance up-to-date. We see no reason to deny these advantages to any insured, and believe that the approval of this program on a countrywide basis is truly in the best interest of the insuring public and to the insurance industry alike.

We do not suggest that the new CGL program can, or will solve all of the insurance availability or affordability problems of today's marketplace but we are confident that it will be seen as a positive step taken by the industry in these difficult times.

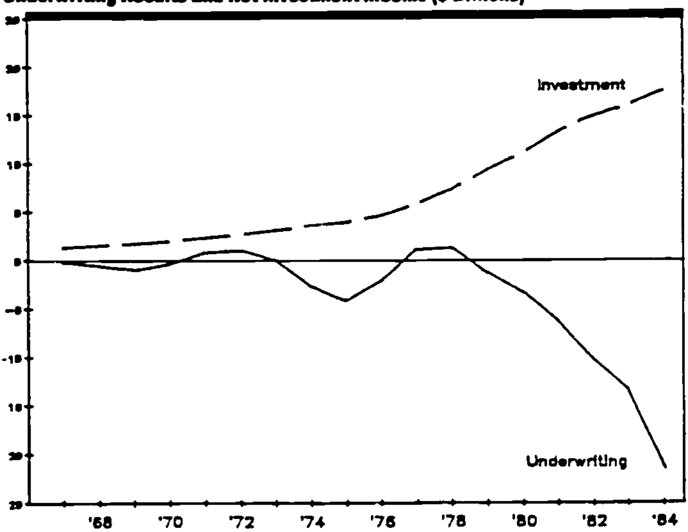
Operating Results

Attachment A

Pretax Operating Income ($ Billions)



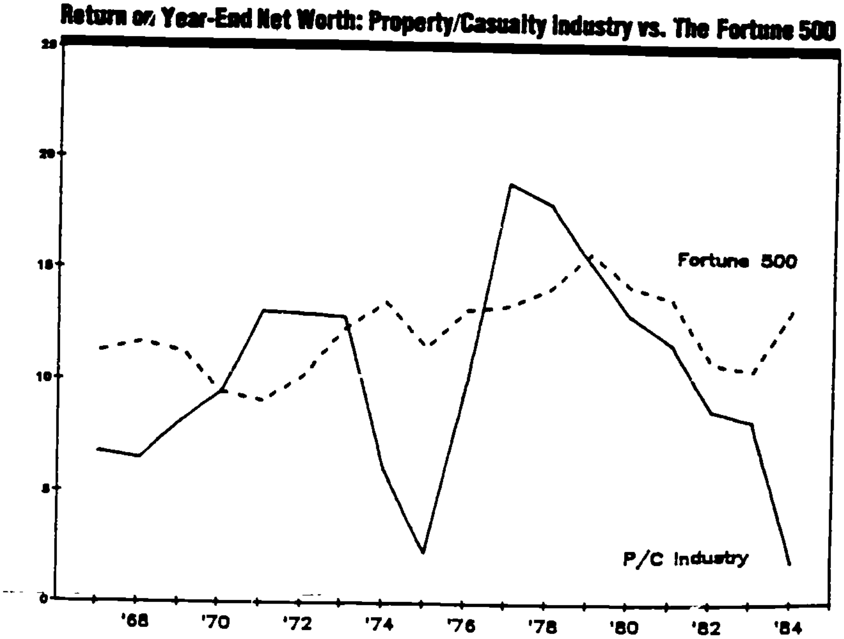
Underwriting Results and Net Investment Income ($ Billions)



Source: ISO 1985, <u>A Critical Year</u>

Attachment 8

Rates of Return



Profits in the insurance business declined in 1984 for the seventh consecutive year and plummeted to their lowest point in at least twenty-five years. The industry-wide average rate of return on year-end adjusted statutory net worth (excluding unrealized capital gains) for the year is estimated at only 2%. Only record realized capital gains of nearly $2 billion prevented net income after taxes from dipping into the red. Negative cash flow and tax considerations in 1984 made realization of long-term capital gains attractive, if not necessary. 50 of the top 100 insurer groups' return on net worth was actually negative.

During the period 1967 through 1984, insurers typically earned less than the average rate of return achieved by other industries in the United States. The annual rate of return on net worth for insurers has exceeded the Fortune 500 for all-industry average in only five of the past eighteen years. In 1984, insurers' rate of return trailed that of the Fortune 500 by more than 11 percentage points. This was the largest gap between these rates of return since at least 1976.

Source: ISO 1985, A Critical Year

Mr. FLORIO. Thank you very much.

Just on the last point, about the claims-made concept. Is it unkind to say that what it is that is happening is you can get insurance, but not for anything you may be concerned about.

For example, when you are talking about long-latency diseases, certainly no one is going to make a claim during the duration, a 1-year insurance claim for an injury that doesn't manifest itself. So in a sense, Johns Mansville is not going to be very much covered for the problems they may want to insure themselves for diseases that are not going to manifest themselves during the period of the claim.

Ms. WALTERS. No, I would suggest, Mr. Florio, the situation with respect to policies, any kind of a policy going in today has got to be, as you were telling Mr. Jones earlier—we are looking forward here for, even if Johns Mansville were to buy an occurrence contract in 1986, that occurrence contract is not going to cover injury which took place 20 years ago. It is the policies that existed 20 years ago that we are talking about.

Mr. FLORIO. Let's say that we are talking about a toxic waste cleanup contractor, whose employee may go out, clean up, may contract something that won't manifest itself for another 10 years. Under a claims-made concept, the fellow has to make the claim, I presume, under the life of the contract. And let's say it is a 2-year contract.

So what the contractor has just done is sign a contract for insurance that is going to be of no value to him 15 years from now when the employee makes the claim for an injury that may have been sustained during the life of the contract.

Ms. WALTERS. The way the new claims-made contract will work, the current—whatever contract of insurance is current will cover the current claims at the currently existing policy limits for the current year's premium.

See today, one of the problems that this claims-made contract is designed to deal with is, when does injury occur. And as you have heard earlier, for certain types of injury; long, latent diseases, et cetera, there is no universal definition of when injury occurs.

Under your example if XYZ Corp. begins in 1986 and buys—as it is intended to work—buys a claims-made contract. Ten years from now they have a claims-made contract. If a claim comes in in 10 years, then that contract in existence 10 years from now with, presumably, adequate limits of insurance which the insured will buy new limits each year to cover the claims that are expected to come in that year, to cover the assets.

Mr. FLORIO. That presupposes that you are maintaining the same insurance to carry you straight through.

Ms. WALTERS. That's exactly——

Mr. FLORIO. What happens if you have got a 1-year policy, John Jones has worked for me for 6 months during this year. In the course of that period of time he is exposed to whatever it is that ultimately is proved to be the proximate cause of his ailment that comes out 10 years from now. I am John Jones and I come back and sue the company. The company is without any coverage, aren't they?

Ms. WALTERS. It all depends. They may or may not be. That company—presumably the company is still in business. They still need to buy insurance. They will have an insurance policy.

Mr. FLORIO. But everyone is going to have—let's assume everybody adopts the claims-made policy. At the time of the suit or the claim, someone is not going to be in a position to get the protection. The company is not——

Ms. WALTERS. Yes. The company. The insurance company, if it has been providing a claims-made contract consistently over that period, the claims-made——

Mr. FLORIO. But we are not talking about over that period. We are talking about——

Ms. WALTERS. When the claim is presented?

If there is no claim brought this year, you don't have any coverage for it this year. If the claim is——

Mr. FLORIO. Under this new approach?

Ms. WALTERS. That's right.

If the claim is brought in 10 years, that is the contract which will respond. And that is—see, what this does is take care of the problem of having to try to estimate how many claims will there be; will there be claims—from the point of view of the insured, we believe this is a very highly desirable product as well, because when you hear about these cases of 10 and 20 and 30 years ago, most concerns grow over a period of time.

What XYZ manufacturing insurance company might consider adequate insurance coverage today might not be what that company considers adequate limits of coverage 10 years from now. So that you could quickly exhaust your limits today, but in 10 years when that claim is presented, you will have bought adequate limits and they will cover the claims that are presented that period of time.

As I say, we don't expect that this will be a panacea by any means. But we believe it is a positive step. It is a valuable tool that is going to help insureds and insurers deal with problems that are within their realm of influence.

I think it is important to emphasize, you have heard a lot of discussion and I think you will hear a lot more about the need for tort reform. But we as an industry, we are not just sitting back and saying "everybody else has got to do something and we are not going to work to try and deal with these very difficult times." We are doing so.

And we have come up with something that has—I think my formal testimony goes into the extent and the lengths to which this new CGL Program has been exposed to all members all over the world, practically, to get input and feedback, and it has been years in development, and we think the product we have now is a very valuable one. It is not perfect, but we think it is very valuable and we are optimistic that we will be able to use this. Not in every case, not for every insured, but it is one alternative that will be available in the marketplace in 1986.

Mr. FLORIO. Let me just ask, if the industry keeps records to differentiate between losses associated with liability verdicts, alleged misinterpretations of the law, or misinterpretations of contracts? Is

there some way that the industry breaks out losses from these types of liability abuses that everyone is interested in?

Ms. WALTERS. I probably should answer that since we are the statistical agency.

Standard insurance statistics do not isolate cause of loss in great detail—data by cause of loss in great detail. But rather, we gather information and compile information by type of coverage and type of claim—meaning is it a bodily injury liability claim or property damage liability claim, and against what class of business is this claim made and how much is paid.

To get very detailed information, one really has to penetrate the claim file. On occasion we, the industry, have done extensive closed claim studies to see what are the underlying causes, or what seems to be driving the problem. We have done that in medical malpractice areas in the past, and we have done it for product liability.

But, on a routine basis, that kind of enormous detail is——

Mr. FLORIO. But without that, how does one arrive at the conclusion that liability is a large, if not the largest part of the problem that you have experienced in the last few years?

Ms. WALTERS. I said we do. We do keep by type, liability coverages, first-party coverages versus third-party coverages. We do keep that.

Mr. FLORIO. The difference between extraordinary liability—I mean, liability is what you are about. The implication here has been that there is some new, extraordinary sense of liability—liberal court decisions, everyone running to court, sovereign immunity being retreated from. One presumes that one has costed out the costs of the extraordinary liability developments that it is now being advocated that we change. Certainly you are not saying we shouldn't have any liability responsibilities.

Ms. WALTERS. Not at all.

Mr. CROSBY. We do try to track these trends, Congressman, by keeping anecdotal histories of horror story cases like the centerfielder running into the female rightfielder.

As far as horror statistics from the claims standpoint, or the tort liability system standpoint, operations like the Institute for Civil Justice that the Rand Corp., has created, which it has been in existence now for about 3 or 4 years, are analyzing court verdicts around the country to determine these trends.

For instance, some of their active studies are trying to detail the punitive damage problem that Mr. Pressman mentioned the city of Baltimore might advocate limiting or eliminating from our civil justice system.

We happen to be the only free-world country that has punitive damages in civil cases. Every other free world country has eliminated them.

The Rand Corp., is trying to study the incidence of punitive damage awards and, like the data that Ms. Walters has described as far as operating income, the preliminary statistics coming out of the Rand Corp., show that the incidence of punitive damage awards is going right off the graph. And we have to predict that in terms of setting our premiums, just as we have to look at what is happening in the stockmarket and operating income.

Mr. FLORIO. I yield to the gentleman from New York.

Mr. LENT. Thank you very much, Mr. Chairman. I want to thank the witnesses as well.

Mr. Hunter in his written testimony said, if you recall, that if the premiums for 1984 had merely been 5 percent higher, the industry as a whole would have earned a rate of return on net worth of about 15 percent. Do you folks agree with that or do you dispute it?

Ms. WALTERS. Yes, sir, most emphatically we dispute it. Let me tell you just a few of the things that rather careless, oversimplified and sloppy work—a few problems with it.

First, the calculations totally fail to consider that when insurers write premiums they have expenses on those premiums right away like premium taxes, agents' commissions, acquisition costs, et cetera. He didn't take that into consideration.

He also didn't take into consideration Federal income taxes which have to be paid on premium. He also failed to consider the difference between the different lines of insurance, although he acknowledges that personal lines is not the problem now, it's commercial lines. He didn't consider that difference.

He also failed to recognize in his rather quick, glib statement that if we had achieved higher income in 1984, the premium increases would have had to come a year or two before that, not right in 1984. The premium increases would have been before that, so that the premium earned in 1984, in fact, the premium increase he suggested, was earned in 1984. So it would be a couple of years before that.

Even just taking into account those few factors which are very simple ones, we have recalculated what would the number be more appropriately. And for commercial lines averages combined countrywide, it would be closer to 45 to 60 percent as a broad average, not 5 percent.

Mr. LENT. This would be in order to make a profit on the underwriting.

Ms. WALTERS. No, no. We're both speaking in terms of total net worth, rate of return on net worth. But one of his problems, too, is he was looking at—his target was wrong. He said we made about 3; we only made 1.7. So to bring that up to 15 percent as he suggested, you only needed a 5 percent—or he is suggesting you only today need a 5 percent increase in premium. Today on the average that number would be probably over 60 percent on the average.

Mr. LENT. The fact is we heard at least some witnesses today who accused the insurance industry of conspiring, as I understood it, to create this insurance crisis in order to obtain rate increases and to affect legislative change, particularly in the tort system.

Mr. Nader has stated that the insurance industry is gambling for high stakes. If successful, the bet will pay off in billions, according to page 1 of his testimony. According to your testimony, the industry as a whole lost before applying carry-forward tax credits from the prior bad years $3.8 billion. I assume that Mr. Nader would view this 1-year loss as an investment made by the entire industry.

Do you have any evidence of companies not being able to rebound from this bad year? That is, have there been any insolvencies or companies targeted for special attention from the state due to their financial condition?

Ms. WALTERS. Yes, Mr. Lent, I'd like to respond to that a little bit and I know there are other members of the panel probably chomping at the bit to get in as well.

My formal statement which I didn't bore you with reading contains a great deal of information on that very subject.

Mr. NUTTER. I think the report was that there are 22 companies that had become insolvent during 1984, and that the National Association of Insurance Commissioners had 418 companies that were on a watch list because they were either impaired or in some critical financial condition.

Ms. WALTERS. Thank you, Frank.

I'd like to mention a followup, and again, I'm sure these other gentlemen would like to add to it. I think you gentlemen probably know as well as we do that this is not a manufactured crisis. Mr. Florio, you are well involved in the Superfund area and pollution liability. I think you realize from the testimony that you have heard there that we're talking about real problems. Product liability, tort reform has been debated and discussed by this Congress and preceding Congresses in their trying to grapple with that very difficult issue.

The whole question of auto no-fault reform has been around a long time, and people are talking about reform because there are injured parties who seem not to be getting the appropriate benefits. And who is really at fault here? I don't know that necessarily we are going to find that we can point our fingers at any one person.

In fact, one of my questions really is, I find it hard to understand why Mr. Hunter and Mr. Nader are arguing so strongly against tort reform. It seems to me the only people who are benefiting from this current runaway tort system may be the trial bar who makes their living off it.

I would suggest very eminent people such as the current Chief Justice of the U.S. Supreme Court have spoken out on this issue, and I also believe the American public feels very strongly about this.

I think all of us in this room realize the American public is absolutely disgusted at the modern version of ambulance chasing which we have seen after incidents like Bhopal and airplane crashes. So I don't think this is something being manufactured. I think that's absurd.

Mr. FLORIO. Will the gentleman yield?

Mr. LENT. Yes.

Mr. FLORIO. Let me just say I don't subscribe to a conspiratorial theory, but I do have some serious problems with the nature in which the industry conducts itself.

When you say who's the major cause, I would quote your own study that says "the property/casualty industry must accept the major responsibility for its current financial condition. But, the brutal price war of the last six years is over." So I think it's incumbent upon us to try to figure out how we got here.

Ms. WALTERS. I agree.

Mr. FLORIO. I can give you anecdotal histories of obscene outcomes with regard to sovereign immunity. I mean, sovereign immunity defense put forward where people were clearly injured and the application of that doctrine worked unjust hardships, so that that's

a legitimate reason under certain circumstances for not following through on that theory.

Let me ask a specific question on this point. How did this come to pass that your conclusion, brutal price wars—what is it we have in place now to stop that from recurring again so that we don't find ourselves with an industry, supposedly a sophisticated industry, out underpricing the premium requirements that it needs in order to make itself financially secure?

Ms. WALTERS. Very good question. That reminds me of several points I did want to bring up before. We have several things at work here. We have—I'll wave the flag—the private enterprise system in the United States which we all choose to operate under, which permits competition. When you have competition I think by and large the public benefits.

We don't have people complaining because they paid very, very low rates over the last 4 or 4 years. People didn't come in and complain because "my rates are being cut 10 percent, 50 percent or 30 percent."

Mr. FLORIO. You just concluded that brutal price wars are, in fact, the cause——

Ms. WALTERS. Hurt the industry. Hurt the insurance industry and brought about to some measure, to a large measure, the industry's financial decline. I'm saying the public is not harmed by paying less than the price they would otherwise pay.

Mr. FLORIO. But if the current situation is an inevitable outcome of what you're just lamenting, what are we going to do to make sure it doesn't happen again?

Ms. WALTERS. Several things are being done. First, in my formal testimony we talk about the primary responsibility of the National Association of Insurance Commissioners, which is to regulate for solvency——

Mr. FLORIO. They didn't do it the last time.

Ms. WALTERS. I beg to differ with you.

Mr. FLORIO. You said the brutal price wars, which presumably were conducted under the guidance and direction presumably of those insurance commissioners, has resulted in the problem we are now facing.

Ms. WALTERS. The insurance commissioners are engaged in protecting the public, not necessarily protecting insurance companies from their own competition.

Mr. FLORIO. Is the public being served by the results of that?

Ms. WALTERS. Yes, sir, they are being served.

Mr. FLORIO. We had a lot of people today indicating they aren't being served.

Ms. WALTERS. I think you're asking me three questions at once. Let me respond to one and then we can go on to some of the others.

The policyholders are, to some extent, benefited during times of excessive competition. Insurance companies are hurt because their financial results show it, but the policyholders benefit from low prices. Even when companies go out of business—this is the only industry that I know of that, in fact, funds guarantee funds which protect claimants if, in fact, companies do go out of business. You don't need a Federal bailout and you don't need a state bail-out. When insurance companies go out of business, the insurance indus-

try funds those claimants. So that's I think an important thing to consider.

The other point I'd like to make when we're talking about yes, there has been aggressive competition. I can assure you, although I don't run an insurance company per se, I can assure you that the managements of insurance companies, as they were competing aggressively for the business, were not planning on the results of that second chart. They were not planning on having pre-tax operating losses. They were hoping, they were optimistic, that even though the premium was out of line with loss costs, that the investment income would be sufficient to overcome it.

They were wrong. Part of the reason they were wrong is we are dealing with the future. We have to determine rates today to cover claims that may occur and may be brought at anytime in the future. That's an inexact science at best, so we were wrong in doing it because it's an inexact science.

We were also wrong because of all these other factors. Even if we could be confident that the policy language and court interpretations of the policy language remain the same, it would be a risky business to begin with.

But we are dealing with a situation now where long after the policy has been written, the premium has been collected, the rules of the game change. And that throws our results off.

My last comment on this question is, I really find it ironic that Mr. Hunter is complaining about taking investment income into consideration today when for the last 8 years, he has been running around the country in all States and before the National Association of Insurance Commissioners saying, you should force insurance companies to take investment income into consideration. They have taken it into consideration, but because it's a very risky business they were off, and they were off on the low side. That hurt them; it didn't hurt the public.

That's all I'll say.

Mr. Florio. By the way, I am not satisfied with the response. It was a long response that dealt with a lot of issues. But I am not sure it dealt with my concern about this whole situation recurring again.

You have indicated the stockmarket is responding to the anticipated profitability of the insurance companies of the industry before too very long, which will duplicate the situation we saw just a few years ago, and there is nothing under the free marketplace forces concept that is going to inhibit other people coming in, competing for the premium dollar, and competing perhaps in a predatory way so as to allow the same process to go forward.

You have asked us to rely upon the State insurance commissioners to make sure that nothing inappropriate happens in the nature of a brutal price war again—and I don't know why we should count on that happening in the future the way it didn't happen in the past.

Ms. Walters. I think you missed my point. I don't think anyone is going to ask State insurance commissioners to protect insurance companies from undercharging people.

Mr. Florio. Why not?

Ms. Walters. Because it doesn't hurt consumers.

Mr. FLORIO. If, in fact, the undercharging results in the insurance company putting itself in the position of not being able to carry out its responsibilities.

That is a legitimate function of the insurance commissioner, isn't it?

Ms. WALTERS. I believe that the legitimate function of insurance commissioners is certainly to maintain solvency and solidity and to see to it that companies don't go out of business. But, it is to protect consumers, primarily, and not to protect—necessarily to protect companies.

Mr. FLORIO. Consumer's interest is dealt with by having a viable insurance company.

Mr. JONES. Mr. Chairman, a number of people think—and I am one of those—that that brutal price war was started by the return that we had in 1977 and 1978. Do you remember it on the chart here, where it is substantially more than Standard & Poors 500.

Mr. FLORIO. As a result of the interest payments.

Mr. JONES. See how well we were doing in 1977 and 1978. We were making almost 20 percent on the money, on your capital structure. And it was a very fluid capital structure. You bought stocks and bonds, you put them aside and they were earning. And that brought a great deal of new capital into the insurance industries. It has been estimated at $5 billion of excess capital.

They went in where it was easiest to go in; they went into the reinsurance industry and they went into commercial lines where they get large returns.

And the industry had to work that excess capital out. Those people wanted to stay in the business. As it declined, they lowered the rates. The established companies who have overheads they have to maintain, had to meet that market. And it was a very great burden in a sense to get it off.

Now, what might cause it to return? Those were very unusual conditions. We were making an underwriting profit and a very extraordinary return on investment was coming into it. Whether that would ever repeat itself or not, one doesn't know. But it does show that we are one of the real free enterprise parts of the economy still. There are a great number of companies, a great number of agents out there competing for business.

Mr. FLORIO. You are also supposed to be a regulated industry.

Mr. JONES. Now there the commissioners do regulate on your homeowners and your automobile, because there are a number of individuals—the individual has to be protected in those situations. And I know commissioners that say they turned down more rate filings that were too low than they did those that were too high—I know one who said he did that. But those were on homeowners and automobile.

We have always said that the large commercial buyer could take care of himself. And the commissioner has assumed less responsibility for the large commercial buyer than he has for the person who has an automobile and owns a home.

And it is in that area where we had the difficulty. It was in that area where we had the greatest amount of new capital that wanted to stay in when they shouldn't have, and made it very difficult for

established industry, and had the least regulation under any regulatory system.

Mr. LENT. I have no further questions.

Mr. FLORIO. Thank you very much. I appreciate your help.

We have one last witness. We appreciate his patience, waiting through the course of the day.

Mr. Andre Maisonpierre, president of the Reinsurance Association of America.

We welcome you.

STATEMENT OF ANDRE MAISONPIERRE, PRESIDENT, REINSURANCE ASSOCIATION OF AMERICA

Mr. MAISONPIERRE. Thank you Mr. Chairman, Congressman Lent. I appreciate your patience.

You have my written statement. In view of the time, let me be very brief this afternoon.

As you have indicated, I am the president of the Reinsurance Association of America. I think it is essential at the outset that one recognizes that what is insurable is reinsurable, and what is not insurable is not reinsurable. Insurance and reinsurance are two peas coming out from the very same, identical pod.

The basic function of reinsurance is to enhance the spreading of risks which is what insurance is all about. Reinsurance allows the primary or ceding companies to reduce their total liabilities to levels appropriate to their premium volume on the one hand, and their equity or surplus on the other.

The usual reinsurance transaction does not involve the policyholder who only looks to his insurer for defense and indemnification of losses.

The reinsurance transaction does not infuse any additional capital into the initial insurance transaction. The premium which the policyholder pays its insurance company is shared between insurers and reinsurers, and in fact is further shared or retroceded amongst reinsurers just as the payment of losses is shared between insurers and reinsurers.

Time this afternoon doesn't permit a full description of the operation of the reinsurance mechanism nor the nature of the reinsurance contracts. We have done this, however, in our written statement.

In 1984 the U.S. property and casualty reinsurance market received approximately $10.9 billion in assumed reinsurance premium. This represents a little less than 10 percent of the total net premium written by all property and casualty companies in the United States.

Historically the ratio of losses incurred to premiums has been fairly comparable for the insurers and reinsurers. Unfortunately, as again we note in our statement, in the recent past the reinsurers have paid a substantially greater percentage of losses incurred by the industry. In fact, the changes in our civil justice system and the interpretation by the courts of insurance contracts in ways never anticipated by the industry have had considerably greater impact on reinsurers than by the primary companies.

These changes in the civil justice environment, retroactive application of liability through legislation and the court reinterpretation of insurance contracts have created intolerable uncertainties in some lines of insurance, particularly in the commercial casualty lines.

The resulting inability of insurers to be able to predict anticipated future losses have made insurers hesitant to invest their limited equity in those lines, any of those lines.

Note that the general liability insurance contract leaves an insurer exposed to claims filed many years after the insurance policy has expired, since the contract provides for coverage of any loss occurring during the policy period irrespective of when the loss is reported.

Insurers and reinsurers today are paying on losses being generated on insurance policies that were sold 20 or more years ago. In fact, in a recent study which our association has completed, we show that the general liability—in the general liability area it is not until the eighth year following the sale of the insurance policy that the reinsurers are made aware of 60 percent of the losses which they will be responsible for under those policies. And, it is not until the 13 year that the companies know of 75 percent of the losses to be incurred.

Now, assuming no change in loss development pattern, the majority of losses on reinsurance contracts covering commercial casualty exposures which we are issuing in 1985 will not be known to us until 1993. And by the end of the century there will still be a large amount of losses not known to the companies.

Now these losses will be adjudicated in the social, judicial, and economic environment which will then prevail. But, let me emphasize this. The premium to pay for those losses must all be collected in 1985, today.

Now, is it any wonder considering the changes that have been taking place in the civil justice environment, that the reinsurance industry underwriting experience of the past several years has been atrocious. In 1984 the reinsurance industry's combined ratio was 133. I believe Ms. Walters stated for the primary industry it was 118. This means for every $100 of premium which we collected in 1984, we paid out in losses, in incurred losses and expenses, $133. In 1983 it was a little better, it was $119. In 1982 it was $114.

What is perhaps troublesome is that in 1984 the reinsurance industry sustained a 7 percent decline in equity, despite a very large infusion of new capital in the industry.

To develop the capacity needed to meet the growing needs of the insurance industry, the reinsurance industry must build an adequate equity base to support such capacity. This equity growth can come from either outside capital being funneled into the reinsurance industry or through profits generated by the company's operations.

Although the strong and well-established companies have been successful in the past several months in attracting new capital either through infusion of capital funds from a parent, or through an instance of one company, the floating of a stock issue, the environment in which reinsurers are operating does not hold out much

promise for sufficient internally generated growth over the reasonable future unless certain changes are brought about.

Predictability of loss patterns must be restored. On a short-term basis we believe that some predictability can be reintroduced by the adoptions by the states of the new CGL contract forms being filed by the ISO.

Ultimately, the availability of insurance and reinsurance will depend on the restructuring of our civil justice system. And we believe that the tort system must provide a fair balance, and until such a balance is restored the problems which have been identified for this subcommittee are bound to persist.

Thank you very much.

[Testimony resumes on p. 283.]

[The prepared statement of Mr. Maisonpierre follows:]

STATEMENT

OF THE

REINSURANCE ASSOCIATION OF AMERICA

My name is Andre Maisonpierre, President of the Reinsurance Association of America, a trade association of professional reinsurers. Our member companies are professional re ,urers principally engaged in the business of assuming property and casualty (p/c) reinsurance and are either domestic U.S. companies or U.S. branches of foreign reinsurers entered through and licensed by a state. All the companies are subject to the regulatory jurisdiction of the various states in which they are domiciled or licensed.

We appreciate the opportunity to address the dual issue of availability and affordability of reinsurance.

Reinsurance is essentially an insurance transaction whereby the reinsurer, for a premium, agrees to indemnify the ceding insurer or reinsured against all or part of the loss which the latter may sustain under its policies of insurance. It is often described as the insurance of insurance companies because it provides reimbursement for the insurer's losses under policies covered by the reinsurance contract. Reinsurance is purchased by the primary or excess ceding insurer for its own benefit so that it can spread its risks and limit its own liability from large or catastrophic losses. The usual reinsurance contract does not involve the policyholder, who looks only to its insurer for defense and indemnity against loss.

Reinsurance was developed to provide capacity essential to the continued growth of the direct insurance industry. In addition to capacity, reinsurance is purchased by a primary insurer to (1) reduce exposure to liability on particular risks, (2) protect against accumulations of losses arising out of catastrophies, (3) reduce total liabilities to a level appropriate to its premium volume and capital, (4) reduce exposure to certain and possibly more hazardous lines of business or alter its "mix" of business, (5) help stabilize operating results, and (6) obtain assistance with new concepts and lines of insurance.

Reinsurance contracts are shaped to meet the specific needs of the ceding insurer, and this freedom of contract is one of the basic tenets of the reinsurance industry. Despite the fact that there are no standard reinsurance contracts, there are two basic types which are used and adapted to accommodate the buyer's business. A reinsurance <u>treaty</u> is a broad and often automatic agreement that covers some portion of a particular class or classes of business, i.e., the ceding insurer's entire workers' compensation or property book of business. In contrast, a <u>facultative</u> agreement covers a specific risk of the ceding insurer and requires the insurer and reinsurer to agree on terms and conditions on a contract-by-contract basis. Both treaties and facultative agreements may be based on a <u>pro-rata</u>

distribution where the two parties share proportionately in premiums and losses. The agreements may also be written on an excess basis, where only the losses of the insurer in excess of a predetermined amount, known as the "retention", are reinsured. It must also be noted that many reinsurers also provide direct excess insurance to policyholders, although this direct business generally represents a small portion of a professional reinsurer's entire book of business.

The 1984 U.S. property and casualty reinsurance market received approximately $11.3 billion in gross premium. Of this amount, $10.9 billion was for reinsurance assumed and $445 million for direct excess insurance. This represented less than 10% of the total net premium written by all property and casualty companies. However, as noted below, the reinsurance industry today absorbs a higher percentage of total losses, and this liability requires a further spread of risk to international reinsurance markets. Foreign reinsurers assume a significant portion of these U.S. risks and, indeed, U.S. insurers paid $1.3 billion more in reinsurance premiums abroad in 1984 than were received by U.S. reinsurers from foreign ceding companies. Much of this premium going abroad is paid by U.S. reinsurers to spread their own risks, and these contracts are called "retrocessions".

Since reinsurers indemnify primary and excess insurers for losses paid under their direct policies, they are impacted by

the same legal and legislative developments affecting property and casualty insurers. Any factors increasing the frequency or the amount of losses will increase the reinsurer's liability, although the effect on reinsurers can be even more dramatic than on direct writers.*

The insurance industry's enormous and still expanding liability in the casualty area under general liability policies issued in the past has had and will continue to have a major influence on the present and future ability and inclination of reinsurers to continue to expose their capital and surplus in these same lines of insurance, until and unless major reforms in both the policy forms and the civil justice system take place. Experience on current and past policies is creating current and future liabilities of such unanticipated magnitude and unpredictable nature that the reinsurance industry finds it almost impossible to assess its present total responsibility.

Insurance policies and reinsurance contracts written in the 1950's and 1960's for relatively low premiums are now responding pursuant to court decisions or retroactive legislation to claims which were never anticipated under the contracts. The resulting impact on reinsurance has been traumatic.

First, these unexpected liabilities as well as other losses are draining the industry's policyholders' surplus and hence its ability to provide the capacity needed in all lines of reinsurance. Second, these losses have highlighted the totally

* For an analysis of the tort system and of the proposals for change, see Appendix A.

unpredictable nature of casualty risks and the liabilities which they create and how these, in turn, can be enlarged by the courts and by legislators. Taken together, these forces are likely to discourage the reinsurance industry from writing risks it cannot understand, rate or limit with any certainty. Instead it will likely commit most of its available capacity to product lines providing some profit potential. As a matter of fact, a reinsurer will need to adopt this behavior if it wants to remain solvent. It must do so for the benefit of all of its client companies and its shareholders.

As mentioned above, the reinsurance industry is today absorbing losses from primary insurers disproportionate to the amount of premiums received. As the following chart comparing the ratio of loss and loss adjustment expenses to premiums for reinsurers and insurers shows, this is a relatively recent development:

	Reinsurers	Insurers
1980	75%	75%
1981	76%	77%
1982	80%	80%
1983	85%	81%
1984	103%	88%

This supports the contention that changes in the civil justice environment and the interpretation by the courts of

insurance contracts in ways never anticipated by the insurance industry have had considerably worse impact on reinsurers than on the primary companies. Note that in the early 1960's, it was common for a reinsured company to offer $5 million or $10 million coverage limits to a policyholder but retain only $50,000 to $100,000, respectively. All losses in excess of those retentions were then intended to be absorbed by reinsurers. However, since it was expected that the reinsureds retention would suffice to cover the majority of losses, the reinsurance premium paid was relatively small.

What has, in fact, happened is that the retention limits of the reinsureds have been pierced with unexpected frequency in just about all lines of business. The result is that reinsurers' past and future liabilities on these contracts are likely to exceed the premium received, plus all the investment income earned on the premium.

The traditional general liability insurance contract leaves the insurer exposed to claims filed many years after the insurance policy has expired since the contract provides for coverage of any loss occurring during the policy period irrespective of when the loss is reported. Certain exposures, particularly in the toxic tort area, are particularly susceptible to this latency factor which is generally referred to as the "long tail".

Although this delay in reporting creates serious problems for all insurers, there is a marked difference in loss development patterns between reinsurers and primary insurers as summarized in the table below. The major reason for these differences lies in the retention feature of excess of loss reinsurance. Since many claims are not valued at ultimate cost initially, the primary insurer may not report such claims to his reinsurer until considerable time has passed because the initial reserve is within the primary insurer's retention. The relative development is much larger for the reinsurer than the primary insurer since the primary insurer's net loss on any particular claim is limited for annual statement purposes to its retention. In addition the primary claim department has more direct control over the administration and adjudication of each claim.

	PERCENTAGE OF ULTIMATE LOSSES			
	1st Year		4th Year	
	Reinsurer	Primary	Reinsurer	Primary
Automobile Liability	35%	80%	80%	100%
General Liability (incl. asbestos)	3%	50%	20%	85%
Medical Malpractice	2%	45%	20%	90%
Workers' Compensation	15%	75%	40%	95%

Source: 1984 Best's Casualty Loss Reserve Development (for Primary only)

This delay creates major problems for reinsurers in the anticipation of losses and, the consequent rating of future business on the basis of accurate loss information. For the past several years we, The Reinsurance Association of America, have been conducting studies in reinsurance loss development trends. In recent years, loss development factors have become larger. With few exceptions, each year's additional information has proved previous loss development patterns to have been optimistic.

Some of the factors that have contributed to these changing loss development patterns are:

1. Automobile Liability -- Development is influenced by such things as the rising costs for medical expenses under unlimited no-fault benefits, changes in the guest statutes, changes from contributory to comparative negligence, and changes in social attitude that have an inflationary effect on settlements.
2. General Liability -- Similar effects for General Liability exist with respect to changes in loss development patterns. These include changes from contributory to comparative negligence, "social inflation", and medical expense inflation. In addition, retention changes (which also affect Automobile Liability) can have some effect on the emerging patterns

of loss development. Mix of business may also be a factor since General Liability includes product liability and other professional liability insurances. As contributing companies may have changed their mix in more recent years, such changes will also have an impact on the development patterns.

3. Workers' Compensation -- Workers' Compensation experience is a function of both indemnity and medical costs. Medical costs, as noted above, have been increasing and therefore the impact of such increases will have an effect on the emerging patterns of development. In addition, new developments in occupational disease may have an impact. Also affecting Workers' Compensation are changes in remarriage, mortality assumptions, and retroactive law changes. In particular, mortality assumptions on catastrophically injured cases may have been optimistic. Liberal interpretations by Workers' Compensation administrative authorities may also be a factor. It is also possible that increased legal representation may influence ultimate losses and consequently the loss reserve development patterns. In the Workers' Compensation line over the past few years, however, there has been litte deterioration. A possible explanation of this seeming stability may be the recent imposition by reinsurers of more stringent reporting requirements in combination with coverage restrictions under late reporting clauses.

This list of possible explanations is not exhaustive, but it does provide a partial explanation for the trends we have observed. The trends during the 1970's and early 1980's are obvious. The implications for the rest of the 1980's are uncertain. In particular, reserving for latent injury and common cause cases will be challenging in an environment of changing judicial interpretations of liability. Further influencing the factors will be the continuing growth of loss adjustment expense in most lines, but especially in General Liability.

It is no accident that the lines of insurance which are the slowest to develop -- the long tail lines -- are the ones creating the worse problems for reinsurers. For instance, under workers' compensation, at the end of the first year of a policy, reinsurers are aware of only 15% of the losses incurred under that policy. By the end of the second year this increases to 25%. By the eighth year, we still know of only 60% of ultimate losses. The pattern is worse in the general liability area -- even excluding identifiable asbestos losses. In that line, by the end of the first year we know little more than 5% of ultimate losses, 30% by the end of the third year and by the eighth year 60%. It is not until the thirteenth year that we know of 75% of the losses that will arise and we slowly hear of the remainder of the losses over the next two decades.

Assuming no change in the future loss development pattern, the majority of losses on reinsurance contracts covering general liability exposures issued in 1985 will not be known to the reinsurers until 1993; and, by the end of the century, there will still be large amounts of losses not known by the companies. Note that these losses will be adjudicated in the social, judicial and economic environment which will then prevail but, the premiums to pay those losses must nevertheless all be collected in 1985.

Finally, it is important to note the potential for complexity of the different coverages making final determination of a reinsurer's ultimate liability in a single risk extremely difficult. Consider one reinsurer's potential involvement at the KinBuc Superfund site, where 95 plaintiffs are suing 667 defendants for personal injury and property damage caused by exposure to hazardous substances disposed of at the site. This reinsurer has identified 137 involvements to date. If the exposure period is, say only 10 years, those 667 defendants may trigger thousands of policies. The reinsurer with 137 involvements must review 10 years of policies and contracts just to check on coverage. At another Superfund site, this same reinsurer found 85 involvements in a suit filed against 190 defendants. This particular reinsurer has located involvement in 250 additional sites, each of which could give rise to a similar

litigation pattern. The lengthening development patterns and the recently emerging areas of unanticipated liability have made it difficult for reinsurers to properly price the protection they offer.

Is it any wonder then, that the reinsurance industry's underwriting experience over the past several years, has been atrocious? The industry's combined ratio has shown a worsening in each of the past five years, as the following table shows:

Year	U.S. Reinsurance Combined Ratio
1984	133
1983	119
1982	114
1981	108
1980	107

A. M. Best - 1984 Reinsurance Results.

What is also particularly disturbing is that this operating loss in 1984 far exceeded investment income. As a result, the reinsurance industry sustained a 7% decline in policyholder's surplus despite a large infusion of new capital in the industry. A. M. Best notes that "the reinsurers posted a negative 14% return on surplus" in 1984, as compared to a 3% negative return for the total property/casualty industry. Best further notes that today, the ratio of Net Liabilities to Surplus for the reinsurance industry exceeds that of the industry average.

What this all means, of course, is that the U.S. reinsurance industry's capacity has diminished substantially at a time when the need of our growing economy for insurance has increased. It should be noted that the decrease in capacity of the U.S. reinsurance industry coincides with a review of the continued participation in the U.S. insurance and reinsurance markets by Lloyds and other alien companies.

What about the future? Availability of an adequate reinsurance market depends on two factors:

1. The ability of the U.S. reinsurance industry to build up an adequate policyholder surplus base to sustain growth.
2. A change in the civil justice environment in which reinsurers must operate.

Surplus growth can come from two sources. One, is the funneling of outside capital into the reinsurance industry. The well established companies have been successful in the past several months in attracting new capital either through an infusion of capital funds from a parent or through the floating of stock issues. This certainly demonstrates faith in the ability of the reinsurance industry to come out of its slump and return to a profitable state. Not all reinsurers have been that fortunate, however, and some have served notice of intention to either quit writing reinsurance altogether or to limit their diminished capacity to the more certain lines of reinsurance.

However, even those reinsurers with adequate capacity will funnel their resources in those lines which provide a certain degree of predictability. Predictability is essential to insurance pricing and it should be noted will be substantially enhanced once the new CGL contract forms developed by the Insurance Services Office are approved by state regulators.

Ultimately, the availability of reinsurance in critical product lines, at affordable rates, will depend on the restructuring of our civil justice system. We are encouraged by the careful and objective review which the Senate Commerce Committee is giving to this issue and we urge the House Energy and Commerce Committee to do likewise. We believe that the tort system must provide a fair balance and until such a balance is restored, the problems which have been identified for this subcommittee are bound to persist.

APPENDIX A

AN ANALYSIS OF THE TORT SYSTEM AND PROPOSALS FOR CHANGE

I. THE TORT SYSTEM

The tort system entails three interrelated purposes: individual justice, deterrence of wrongful conduct and compensation. It is adversarial with remedies tailored to the individual. Classic tort theory requires for the plaintiff to recovery that he prov' by a preponderance of evidence that identified defendant owed him a duty of care and that the defendant failed to meet this duty and thereby caused the harm suffered by the plaintiff. Restatement (Second) of Torts §282 (1965). Importantly, even classic notions of "strict liability" entail some judgment as to the character of the defendant's behavior. Courts normally balance "risks against utility" of conduct in "strict liability" cases. Also, cases of product design and warning entail consideration of the reasonableness of the manufacturer's conduct.

The tort system's procedural, substantive and evidentiary rules - necessary for a "fair" individual outcome - are time consuming and expensive for the parties and taxpayers. However, the quid pro quo is that a successful plaintiff may obtain a generous recovery. Damages include compensation for past and future economic loss and compensation for non-economic losses such as pain and suffering. Also, the plaintiff may recover punitive damages with the aim of punishment and deterrence. Lastly, recovery is allowed without evidence of compensation from collateral sources such as insurance policies, workers compensation or other benefit plans. Thus, the tort plaintiff enjoys recovery without formal cap or limit.

Increased technological complexity and the increased ability of science to suggest, if not confirm, causal relationships between certain ailments and exposure to certain substances is in large part responsible for the crisis that has developed within the tort system. In situations of long latency disease, unidentifiable defendants, or lack of proof of fault, some courts have expanded classic tort theory to allow recovery where none would have been allowed. Strict liability theories are being expanded and recovery allowed in situations not previously contemplated. Increasingly courts are allowing recovery against "innocent" defendants where the actual person at fault cannot be determined.

Strict Liability: Under classic tort theory a person is liable even where due care was exercised if the product produced nevertheless contained an unreasonably dangerous aspect, or if the nature of the defendant's activity was unreasonably dangerous. Restatement (Second) of Torts §402A. Notions of strict liability, however, are expanding in terms of the activities and products to which the theory is being applied. Compensation for Injury from Exposure to Hazards: Report of the Ad Hoc Business Council on Injury Compensation, U. S. Chamber of Commerce (1985) at 51. Products and activities formerly subject to a negligence standard are being subject to strict liability standards. More industries are being held to standards of care higher than that of reasonableness. This is a result of increased complexity of industry and products.

Certain defenses formerly allowed in strict liability cases are not recognized by some courts. For example, manufacturers, even in strict liability cases, had been able to rely on the state of the art defense. No manufacturer would be held liable for harm caused by conduct or products that could not have been anticipated under state of the art knowledge. Recently, however, some courts have essentially turned to a concept of absolute liability. Beshada v. Johns-Manville Products Corp., 447 A.2d 539 (N.J. 1982); Elmore v. Owens Illinois, No. 65 374 (Mo. July 17, 1984) (en banc); Hayes v. Ariens, 391 Mass. 407. Despite the fact that the New Jersey Supreme Court has retreated somewhat from its holding in Beshada in a non-asbestos case (Feldman v. Lederle Labs, 479 A.2d 374 (N. J. 1984)), the issue of availability of the state of the art defense remains at best unclear. The policy reasoning of Beshada is available in future cases anytime a court believes that as between an "innocent" plaintiff and an "innocent" defendant, it is fairer that the plaintiff should recover.

Unidentifiable Defendant: A second area in which the courts have eased classic notions of proof based on increasing societal complexity is where the party allegedly at fault is not identifiable. This problem of proof has most often developed in long latency disease cases, including those involving DES and asbestos. Courts, in an effort to provide recovery, have developed several theories to overcome the burden of proving the identity of the defendant that actually caused the harm including: conscious parallel conduct as "agreement" among defendants in marketing of products, Bichler v. Eli Lilly & Co., 55 N.Y. 2d 571, 436 N.E. 2d 182 (1982) (DES case); concert of action by express or tacit agreement, In re Beverly Hills Fire Litigation, 686 F.2d 385 (6th Cir. 1982); enterprise liability making each manufacturer jointly/severally liable for injuries caused by adherence to an industry-wide standard, Hall v. E.I. Du Pont de Nemours & Co., 345 F. Supp. 353 (E.D. N.Y. 1972) (usually

applied where only small number of manufacturers in industry); and market share liability, a policy decision that as between innocent plaintiff and manufacturer the loss should be spread among members of the industry and the public, Sindell v. Abbott Labs, 163 Cal. Rptr. 132, 607 P.2d 924, cert. denied, 449 U.S. 912 (1980) (DES).

Proof of Causation: A third area where courts and commentators are entertaining a tendency toward expanding classic concepts of liability because of long latency and complex but unresolved scientific questions is in proof of causation. Judicial decisions concerning the appropriateness of the use of epidemiological evidence to prove causation are mixed. See cases discussed in J. McElveen and P. Eddy, Cancer and Toxic Substances: The Problem of Causation and the Use of Epidemiology, 33 Clev. St. L. Rev. 29 (1984-85). However, commentators are calling for admission of such studies into evidence. There have been numerous legislative proposals that would permit recovery based on probabilities of causation derived from epidemiological studies. See, e.g., S. 1483 97th Cong., 1st Sess. (1981) (compensation for nuclear testing) S. 1483 initially would have created a presumption of causation if the individual worked or lived in an "affected area" for a time and had developed cancers identified by an Advisory Panel as being related to the radiation hazards. Both the Black Lung Benefits Act, 30 U.S.C. §§901-945 (1976 Supp. V 1981), and the Longshoremen's and Harbor Workers' Compensation Act provide for coverage presumptions. In effect these presumptions shift the burden of proof to the defense to demonstrate that its product or conduct could not have caused the harm alleged.

Deep Pocket Theory of Recovery: More directly involving insurers, the courts, in long latency disease cases, have shown a tendency to interpret insurance contracts, despite the contract's wording, in a manner so as to broaden coverage. Various theories have been developed to expand coverage under "occurrence" based policies. At best there is much confusion over when an occurrence takes place in long latency disease cases. Some courts hold that terms such as "bodily injury, sickness or disease" as "occurrences" are ambiguous in the context of latent or cumulative diseases and thus interpret them adversley to insurers. Keen v. Ins. Co. of North America, 667 F.2d 1034 (D.C. Cir.), cert. denied 455 U.S. 1007 (1982) (triple trigger "occurrence" of bodily injury during exposure, exposure in residence and manifestation); Zurich Ins. Co. v. Raymark Industries, Inc., Slip Op. No. 78 L 8760 (Cir. Ct. Cook County Ill., Sept. 28, 1983) (double trigger "occurrence" upon exposure in residence and manifestation). Some courts, however, use the manifestation rule, Eagle-Picher Industries, Inc., v. Liberty Mutual Ins. Co., 682 F. 2d 12 (1st Cir.), cert. denied, Froude v. Eagle-Picker, Industries, Inc., 103 S.Ct. 1279 (1983).

Similarly, where there has been progressive property damage, some courts hold that insurers are liable pro rata for the entire period. Gruol Construction Co. v. Insurance Co. of North America, 11 Wash. App. 632, 524 P. 2d 427 (1974). Others, however, hold that the "occurrence" takes place when the damage has rendered property "defective". Bartholomew v. Insurance Company of North America, 502 F. Supp. 246 (D.RI. 1980), aff'd. sub nom. Bartholomew v. Appalachian Ins. Co., 655 F.2d 27 (1st Cir. 1981).

The courts have also shown a tendency to ignore pollution exclusions. Negligent selection, design or construction of a dumpsite or failure to clean-up may mean pollution damage is not excluded. Price v. Selected Risk Ins. Co., doc. no. L-69122-80 (N.J. Super. Ct., Feb. 26, 1982). The "sudden and accidental" exception to the pollution exclusion has essentially been expanded so as to interpret the pollution exception out of existence. Where the resulting pollution damage is merely unforeseen or unintended and thus "accidental" courts will find against exclusion. Jackson Township Municipal Utilities Authority v. Hartford Accident & Indemnity Co., 186 N.J. Super. 156, 451 A.2d 990 (Super Ct. 1982); Farm Family Mutual Ins. Co. v. Bagley, 64 A.D. 2d 1014, 409 N.Y.S. 2d 294 (4th Dept. 1978); Grand River Lime Co. v. Ohio Casualty Ins. Co., 32 Ohio App. 2d 178, 289 N.E. 2d 360 (1972).

Similarly, on-site clean-up exclusions are ignored where clean-up is required to prevent damage to third parties. Bankers Trust Co. v. Hartford Accident and Indemnity Co., 518 F. Supp. 371 (S.D. N.Y. 1981). Insurers may also be liable for statutory penalties imposed for delay in clean-up activities if the penalty is the result of dilatory or "bad faith" non-cooperation by the insurer. Kutscher's County Club Corp. v. Lincolns Insurance Corp., 464 N.Y.S. 2d 136 (Sup. Ct. 1983).

II. CRITERIA/TORT SYSTEM

Analysis of the tort system must begin with identifying its purposes. Fundamentally, the tort system is intended to place liability for harm on the party responsible for the harm. Where a plaintiff cannot recover because there is no wrongdoer or none can be identified, denial of recovery is appropriate. The system was not designed to provide recovery in such situations. A review of classic tort recovery according to fairness and predictability criteria leads to the conclusion that the tort system provides a fair means of individualized recovery within the circumstances it was designed to meet.

However, some segments of society believe that certain individuals should be allowed tort recovery in circumstances not contemplated under classic tort theory. The result is a disjoint in the system that is harmful to society as a whole.

Commentators have applied the following criteria to recovery systems in an effort to evaluate adequacy in relation to purpose:

- Fairness to society as a whole
- Fairness to individuals
  - timeliness
  - efficiency
  - amount of compensation
  - consistency of result
- predictability of frequency and amount of recovery

Application of these criteria to the classic tort system reveals the following:

<u>Fairness/Access</u>: Use of a "discovery rule" statute of limitations rather than a date of injury rule is appropriate for long latency harm. Statutes of repose may bar some claims, but they are essentially fair. Proof becomes more difficult over the passage of time. At some point proof of facts becomes so costly and questionable as to preclude hearing the case within the tort system.

<u>Identifying Defendant/Causation</u>: Access to the tort system may be precluded where the plaintiff cannot identify the defendant or prove causation. However, under the fault based system denial of access is appropriate. Compensation under such circumstances is not contemplated, except in very limited circumstances under classic tort law.

<u>Insufficient Recovery</u>: Access may be denied where alleged damages would not cover the expenses or time spent in bringing an action. Even with a contingency fee arrangement recovery may not be sufficient to make the effort worthwhile.

<u>Timeliness/Efficiency</u>: With an emphasis on proving individual liability and damages, the tort system is neither prompt nor inexpensive. Trials are lengthy. Costs and attorneys' fees are high. Even where parties reach settlements, often much effort is spent on evaluating technical complexities of a case. However, this aspect of the tort system is the price paid for the potential of large recoveries, including pain and suffering, and in some cases, punitive damages.

<u>Amount of Recovery</u>: Plaintiffs receive economic damages without reduction of benefits received from collateral sources.

The rationale is that the defendant, because he is at fault, should pay the full damages caused by his wrong. In addition, tort law provides damages for pain and suffering. These damages are also justified by the defendant's fault. The defendant should be responsible for compensation of all harm he caused, even if it is not readily susceptible of economic evaluation. If the defendant's conduct is determined to be sufficiently aggregious, punitive damages may be awarded. The tort system thus may award damages far in excess of actual, net economic compensatory loss.

Consistency: Given the variety of state rules of liability, results in tort cases vary substantially. There are further uncertainties inherent in a system dependent on juries and attorneys.

Insurability: The lack of consistency in result means that the tort system is less amenable to actuarial development of risk of loss. Even if tort theories were to remain relatively stable, the unpredictability in award amounts, particularly pain and suffering amounts, makes it more difficult to predict risk than for a system where benefits can be objectively quantified.

The inherent lack of predictability is exacerbated by the recent expansion of tort liability and recovery theories that, at best, create confusion in the effort to predict case results and award amounts. These changes in tort law are the result of attempts to alter the system to allow recoveries where none had been previously intended. The tendency has been to reduce the burdens of proof and ease recovery for plaintiffs who otherwise would have no cause of action. Much of the change is the result of long latency harm caused by products and pollution.

Classic tort rules concerning proof of fault, identity of the defendant, proof of causation, and insurance contract coverage have been broken by the courts to allow recovery. The result is an unpredictable system where plaintiffs remain entitled to receive individual compensation without limitation, but enjoy relaxed burdens of proof more appropriate in a no-fault system. The tort system is in flux, but only in one direction: increasing potential liability.

III. PROPOSALS FOR CHANGE

Proposals for change generally fall into three categories, depending on the particular aspect of the system focused on: 1) increasing judicial resources; 2) alternative dispute resolution; and 3) alteration of procedural and substantive rules of law.

Those interested in reducing the expense and delay of the tort system argue that more resources are needed. Increased numbers of judges and court personnel are necessary, it is argued, to keep pace with the increased legitimate litigation demands of a growing population. Such proposals, however, lack merit. Judicial resources have been increased. The result has simply been increased procedural complexity. Moreover, increasing judicial resources has done little to promote fairness or consistency and thus predictability in result. Indeed, increasing the number of judges would tend to increase inconsistency and thus reduce insurability. Certainly this proposal could do little, if anything, to cure recent distortions of classic tort law.

The need for reduction in time and expense of litigation has led others to argue for alternative means of dispute resolution. However, the experience of many in the use of "binding" arbitration is that the non-judicial procedures begin to grow more complex coming to duplicate the procedures they were intended to replace. Moreover, alternative dispute resolution can be counter-productive, merely adding another layer to the litigation process. Dissatisfied parties often seek further redress in the court system. Accordingly, rather than serving as an answer to abuses of tort litigation, alternative dispute resolution may increase opportunities for abuse.

The third broad area for proposed change is alteration in procedural or substantive law. Procedural changes could result in easing the time and expense pressures of litigation. For example, procedural rules could be enacted that would require more than mere notice pleading. Fewer unmeritorious cases would be allowed beyond the pleading stage. Discovery in cases surviving dismissal could be much more strictly limited. The use of summary judgments might be expanded, and jury selection procedures could be curtailed.

Again, however, such procedural "tinkerings" with the system, while they might reduce time and expense of litigation, would do little to curb recent distortions in substantive tort law designed to allow recovery to persons who otherwise would fall outside the system. Because much of the crisis surrounding the current tort system flows from expansion of substantive rules of tort law, the focus for change to develop predictability and fairness of outcome must be substantive. A balancing should be made between recovery systems which focus on individual fault and those intended to provide recovery where fault is not provable.

Consideration of tort reform must include a societal perspective. As discussed above, under classic tort law, it was deemed fair that the plaintiff meet certain burdens of proof to

allow individual recovery including compensation for non-economic loss. By focusing on individual loss, however, in an effort to be fair to individuals suffering loss but unable to meet the classic burdens of proof, the courts have altered the system unfairly to society as a whole. The system has become too costly and unpredictable. Thus, before fundamental changes can be evaluated according to the criteria above, three basic questions must be answered: who is to be compensated, from whom is compensation to come and what amount of compensation is to be paid? If the answers to these questions are: those who can prove harm through fault of another, those who caused the harm, and full recovery of all los 's caused, then the traditional tort system is adequate under the criteria applied. But if the first answer is changed to include all those who are harmed, the tort system is an inappropriate compensation mechanism.

A balancing of society's interest with that of the individual should argue against the expansion of the fault-based tort system to provide unlimited recovery. Apparently society, or at least the judiciary, has decided to expand the universe of those who may obtain compensation to victims of harm whose cause may not be provable under classic tort concept . What has happened is a transformance of the system into a no-fault system for plaintiffs, but with retention of the notion that individual defendants remain liable not only for compensation, but for pain and suffering damages and even punitive damages. Thus, from a societal standpoint the system is too costly. Pain and suffering awards and punitive damages have no place in an essentially no-fault system. Without fault, deterrence and punishment have no meaning. Rather than deter wrongdoers, such a system stifles product and service development and causes curtailment of product production and services that redound to the overall good of society.

Thus, the question of alternatives may come down to selecting among degrees of fault and no-fault concepts, and the policy trade-offs that must be made between the two kinds of systems.

Administrative System: A number of commentators have suggested that present day tort recovery is completely outmoded. Recovery for products liability, medical malpractice and environmental harm has evolved to the point where recovery for workplace harm had evolved by the turn of the century. Thus, it is argued that an exclusive administrative no-fault system be designed to replace the fault-based tort system for all injury compensation, or for specific categories of injuries.

This remedy could be designed a variety of ways. An administrative fund could be created from industry, government and insurance contributions such as the Black Lung fund. Or,

more in the nature of workers compensation, a mandatory insurance/self-insurance program could be established.

The system theoretically would provide recovery in a more timely manner, more efficiently, with reduced transaction costs and more consistency of result for individuals. Because it would be a no-fault system, evidentiary standards, particularly proof of causation, would be reduced. Also, if recovery is to be from a centralized fund, there would be no need for proving the identity of any particular defendant. All that need be demonstrated would be that the claimant had suffered harm, which based on some probability limit, was caused by a product, activity or ste of a covered industry.

Because the system would be no-fault, recovery would be limited to economic loss and could be designed to reduce any recovery by the amount of collateral awards.

An exclusive administrative system could provide a more predictable outcome by virtue of elimination of pain and suffering awards and the preclusion of stacking on collateral benefits. However, more individuals would likely seek recovery thus offsetting savings on pain and suffering awards. And the additional number of claimants is not predictable.

A major criticism of a complete no-fault system is that careful businesses would subsidize the less careful. Such a system would reduce incentives to protect the public. Commentators, however, have stated that this difficulty could be avoided. If the system used a fund, the administrator could recommend increased contributions from those at fault. Penalties would be imposed for negligent conduct. However, recovery by the administrator against those at fault under traditional tort concepts could recreate the problems of cumbersome tort recovery.

If the system were based on an industry size basis, the problem of deterrence could be mitigated by requiring defendants to decide the share each should pay. This mechanism has been used voluntarily in airline disasters. If fault could not be demonstrated, the award would be divided evenly or based on a formula.

A major difficulty with this system, however, is that it may appear unfair to the individual in denying pain and suffering awards where suffering and fault are severe.

<u>General Compensation Fund</u>: Using the same arguments as used for the Administrative System, some commentators have suggested the broadest possible recovery system: creation of a general treasury fund participated in by all industries. A

general fund could be in the form of expansion of the Social Security system or national health insurance. Essentially, everyone who is somehow harmed by living in our society would be compensated from the fund.

The administrative recovery theoretically would be relatively quick assuming such a vast number of claims could be timely processed. There would be reduced transaction costs on an individual basis. The system could develop a predictable albeit large overall payout making insurance mechanisms feasible.

Such a general fund, however, would probably be too complex to administer. Contributions to the fund could also affect U.S. industry ability to compete with foreign producers. Also, such government entitlement programs tend to expand beyond purposes for which they were developed. Such a general solution may be workable in a relatively homogenous culture such as Japan. However, even the Japanese system has experienced major administrative difficulties. In the U.S. there may simply not be enough money or bureaucrats.

Two Tier/Non-Exclusive: After the so-called Superfund section 301(e) Study Group Report, (Injuries and Damages from Hazardous Wastes - - Analysis and Improvement of Legal Remedies: A Report to Congress by the Superfund Section 301(e) Study Group. Serial No. 97-12. Sen. Comm. on Environment and Public Works. 97th Cong. 2d Sess. (1982)), there were numerous bills (see e.g., H.R. 2582 98th Cong. (Rep. Markey), S. 946 98th Cong. (Sen. Mitchell)) introduced that would have created a two tier administrative/judicial recovery system for hazardous waste injuries. These proposals, however, would not make the administrative and judicial tiers exclusive. The purpose of these proposals was to achieve the logical conclusion that expansion of the tort system is moving toward, a no fault system providing full compensation.

Tier 1, the administrative remedy would provide quick compensatory relief based on reduced evidentiary standards and shifted burdens of proof in return for limited, objectively determinable damages. Tier 2, the judicial tier, (structured according to traditional tort standards or liberalized standards reducing plaintiff burdens) would also be available, but with reduction in award by any amount recovered under tier 1.

This type of system has been criticized as blurring the no-fault and tort remedies to the extent that unlimited damages would be allowed based on relaxed no-fault standards of proof. Moreover, claimants could use recoveries under tier 1 to fund tier 2 litigation. Defendants would be forced to litigate twice creating additional transaction costs. The non-exclusive two

tier system is probably the only alternative suggested that would be worse than the present tort system.

Two Tier/Exclusive: Recently, several proposals have been developed that would create a two tier administrative/no-fault judicial/fault system, but which would make the proceedings exclusive. The concept is intended to simplify the system by encouraging use of the no fault system to achieve relatively quick, certain recovery of net economic loss and reduce incentives for seeking more questionable recovery of pain and suffering awards. The administrative system would permit only net economic awards. Awards would be reduced by collateral recoveries. The approach would be to rid the system, to an extent deemed fair, of pain and suffering awards, large transaction costs (commentators claim most of the transaction costs arise from pain and suffering disputes) and collateral awards.

Currently, there are several models for this approach. Each essentially is structured as follows: Alleged victims would have the choice of bringing a claim according to a no-fault non-judicial proceeding or suing in tort based on proof of fault. The no-fault proceeding would entail a claim made directly against the defendant for net economic loss only. If the defendant, who must respond within a relatively short time, agrees on liability and payment, the claimant is foreclosed from proceeding under the tort remedy. If the defendant refuses to make an offer, the claimant would be allowed to sue in tort and obtain an award for pain and suffering. Alternatively, the claimant could seek a court order declaring that the defendant is liable under the no-fault system and ordering an increased award, including attorneys' fees, necessary to bring the injunctive action. If the judicial proceeding were chosen, the claimant would be precluded from bringing an administrative action.

The exclusive two tier systems can be structured in a variety of ways benefiting defendants or claimants in the effort to encourage the selection of tier 1. For example, a claimant's burden in tort trial may be eased if the defendant has turned down a net economic loss claim. Additionally, in such a situation, the claimant might be entitled to double damages. On the other hand, if the claimant rejects an offer of payment for net economic loss, it might face added proof burdens in the judicial system. Failure to prove at least negligence, even in a classic strict liability case, could result in the claimant paying the defendant's attorney fees and receiving only net economic loss.

Such proposals have been advanced by Senators Danforth, Gorton and Dodd. Additionally, it is a model used for federal

medical malpractice legislative proposals. The approach offers an efficient, quick no-fault recovery system in exchange for the rights to pain and suffering awards and to stacking collateral recoveries. The intent is to encourage quick settlement for net economic loss.

Such proposals provide what may be perceived as a fair trade-off between timeliness/certainty of recovery where there are problems of proof and the amount of recovery available. Uncertainty is removed to some extent by making recovery for pain and suffering less attractive. Net economic loss, of course, can be more objectively determined. However, insurability of the system remains uncertain unless it can be determined from an economic and actuarial standpoint what total payouts will be. The lessened uncertainty of pain and suffering payments may be offset at first by increased uncertainty over the numbers who will avail themselves of the system.

Special Tribunals: It has been suggested that certain industry-wide cases (e.g., asbestos, DES, Agent Orange) be removed from the judicial system and be decided by special tribunals. Tribunals could be judicially selected and be made up of judges, experts or some other group deemed qualified. Circumstances for creation of a special tribunal would require some measure of scientific evidence that a particular product or substance is causally linked to a particular harm. Recovery could be based on a no-fault system, but limited to net economic loss. A particular advantage would be that the courts would be relieved of substantial burdens.

The major difficulty would be in developing criteria and a trigger mechanism for removing industry wide "torts" from the judicial to the tribunal system. As long as individuals think that they may be the lucky ones and receive the "jackpot" of pain and suffering or punitive damages, there may be objection to such removal from the judicial system on a large scale basis.

The system could provide a more quick, efficient recovery and greater predictability in costs and payouts once put into effect. However, development and application of trigger mechanisms may be too cumbersome and controversial to be feasible.

Piecemeal Changes: A number of organizations have approached the issue of civil justice reform by addressing both procedural and substantive changes individually. For example, the Alliance of American Insurers suggests addressing: alternative dispute resolution, class action, comparative negligence, contingent fees, discovery abuse, jury instructions, prejudgment interest, pain and suffering awards and punitive damages.

For the most part this approach seeks to "limit abuses" in the tort system without addressing the underlying causes of the abuses. For example, it is suggested that caps be placed on the size of pain and suffering awards, contingent fees and punitive damages. The result if achievable would be reduced awards. However, the result may not be achievable because the approach is politically unsound in that there is no quid pro quo provided for those who society seemingly wants compensated, but who would be denied compensation under classic tort theory.

Maintain the Present System: It must be noted that a recent report to the American Bar Association (Towards Jurisprudence of Injury: The Continuing Creation of a System of Substantive Justice in American Tort Law, Report to the American Bar Association, Special Committee on the Tort Liability System (1984), a special ABA Committee concluded that

> while many improvements are desirable in the conduct of dispute resolution, the adversary process gives point and content to a body of law that produces a consistently high quality of substantive justice.

The Committee suggests a number of procedural and administrative experiments for obtaining quicker resolution of disputes. The suggestions are generalizations that few could quarrel with such as: "We recommend that every court handling civil cases should establish protocols designed to increase judicial efficiency", "Lawyers . . . have an independent responsibility to help the legal process to operate efficiently".

The ABA Committee has concluded that punitive damages must remain as "an important bridge between tort and criminal law" but that rules should be formulated to "limit punitive damages . . . to amounts that serve the policy goals to which those sorts of damages are referable." Pain and suffering awards, in the Committee's view, are "an integral part of American tort damages law" and should be maintained. Moreover, "to remove collateral sources from tort judgments would clash with prevailing concepts of fairness and individual responsibility and would undermine socially valuable incentives for self-protection". Finally, the Committee concludes that "joint and several liability against multiple tort feasors is a desirable feature of our tort law".

While the Committee's generalized suggestions for improvement are commendable, nothing is offered in the way of a solution to the problem of expanding compensation without creating undue societal burdens. The problems have developed

because tort law has been distorted so as to allow recovery, pain and suffering awards and punitive damages where classic tort law would not have allowed recovery.

Product Liability Legislation/The Kasten Bills: For a number of years the Senate has considered and reconsidered products liability reform legislation introduced by Senator Kasten. Each session that legislation has failed to pass, and this past May it failed passage in the Senate Commerce Committee. Essentially this bill would have nationalized tort law so as to provide strict liability in defect in manufacture cases and express warranty defects, but apply negligence standards for design defects and failure to warn cases. Pure comparative negligence would be used. The bill became a series of compromises over existing tort theories. Through numerous revisions the bill, in the view of many, became little better than the system it was intended to replace, in that courts would be given freedom to apply the law with the same degree of discretion that they have applied the common law. Accordingly, because of the dissatisfaction of former proponents, it is doubtful that this form of products liability legislation will see further support on its own merit. However, it could be used as a model for tier 2 in the two tier exclusive system.

Mr. FLORIO. Thank you very much.

On the nurse-midwife issue, I think you heard the nurse-midwives say the primary carriers were prepared and willing to provide coverage. It was the reinsurance companies that were the basic problem, as they had to have coverage up to $1 million.

There was also some suggestions that the loss payout amount for nurse-midwives was not substantial.

What—if you know—is the rationale for reinsurance companies not providing the excess coverage?

Mr. MAISONPIERRE. In the first place, I am not exactly sure that I understand what they are talking about.

They say that the primary company was prepared to provide $100,000 and they couldn't get excess insurance. There is a difference between excess insurance and reinsurance. $100,000 will mean that the primary company would itself spread out the $100,000 risk through reinsurance. And it is possible that the primary company was prepared to provide this and had suggested to the midwives that there are no excess of loss carriers there that are prepared to provide a higher layer of coverage than they, the primary company are prepared.

I'm not an expert in the excess surplus and excess line area. But I do know that there has been a very substantial dwindling of the market. The dwindling of the market has come about because many of the excess and surplus line companies were companies which had been formed in the recent past by parents that were really not insurance oriented and had not had any traditional attachment to the reinsurance industry.

Many of the parents are aware of commercial enterprises, as Mavis indicated. They were attracted to the insurance market during a period of time when there was perhaps substantial funds to be made through investment. They got into the business and they go out once the investment opportunities disappeared. So the excess and surplus market has dwindled.

It has also dwindled because even those companies that had long traditional attachment to insurance and went into the excess of loss business found that it was an impossible situation, and they lost their shirts.

Additionally, some of the State regulators, including one in your State, imposed such severe regulatory restrictions on the excess and surplus line business, the companies just abandoned the business.

Now, if it is a matter of the companies saying, yes, we are prepared to provide a $1 million per occurrence limit, but we cannot get adequate reinsurance to spread the risk—I don't know which company they are talking about, I don't know whether this may be a new line for that particular insurance company, and the traditional reinsurance relationship which that company has had may not find that particular line one in which they have any underwriting knowledge, and one in which they can, in fact, invest because they don't know what they are doing.

Reinsurance underwriting is even more complex than primary company underwriting. And I am not about to say here as to what are the reasons why a specific reinsurer may have or may not what it may have said. It is possible the company may not have been in

a position to provide the reinsurance coverage at the very, very high layers.

We do know that in other professional liability coverage, whether it be architecture, accountants, office and directors, the reinsurance market has been hit at levels which were never anticipated. And I should tell you that even our own directors are finding it difficult to get insurance and reinsurance, because the nature of the lawsuits which are being brought against professionals today is quite different from what it was even 2, 3 years ago.

And yet we are responding on—the policies which are responding today on policies which were written at a time when the system was quite different.

Now you may say well, you know what the system is today, you know what you are dealing with, you can deal with this and you can underwrite this.

This would be true if we could count on a certain degree of stability in the tort system, as the court system. But we cannot. As our figures indicate, it will take—there will still be about 25 percent of the losses that we will pay out that we will not even know of those losses by the turn of the century. We must collect all the premiums today to pay for those losses at the time.

This is why the claims-made policy will provide a much greater stability, predictability, and will open up the coverage. I cannot foresee of anybody who would not be covered and where there would not be a policy in force.

Ms. Walters indicated that the claims-made policy in force at the time the claim is made, regardless of when the occurrence happened, will respond to the loss.

Let's say the individual goes out of business, that the XYZ company goes out of business. Well, under the ISO policy the industry would be obligated to provide a tail to that policyholder to cover all losses to be reported in the future. So the policyholder is protected. The claims that will be filed by that policyholder will be protected.

For the most part, what we are doing is compacting the time element between underwriting, pricing and payment of losses. And I think that this will create a great deal more stability in the pricing of insurance than we have today.

Mr. Florio. Let me ask you a question with this claims-made, because I am really not clear on it yet.

1990, XYZ company has an insurance policy that is different than it has right now. Insurance company. It is a claims-made policy.

Worker who is working and injured, exposed this year, in 1990 goes to the company, different insurance carrier, comparable policy. Files the claim. Company turns it over to the insurance company.

You are saying that the insurance company at that point will be responsible because the claim was made even though the insurance company with the insurance policy was not the responsible party at the time that the exposure took place.

Mr. Maisonpierre. The claims-made policy, as well as the occurrence policy provide which insurance policy shall take precedence, so that there is no doubt as to which of the policies will prevail.

Under the present system—and this has been a major problem particularly in the asbestos area—we don't know which policy prevails. Take the asbestos situation, an individual is exposed to asbestos—was exposed over a period of 10 years to some asbestos exposure. The company has had, let's say 10 different policies over the period of 10 years.

Now the courts are telling us that the policies which will respond will be all of the policies which were, in fact, in effect from the date the individual became exposed until the individual files a claim or dies, because there is an increase in the disability morbidity resulting from the asbestos.

So you have a whole series of policies responding to claims today.

Under the proposed program of ISO, there is a clearcut delineation as to which policy will respond. And that will eliminate a great deal of friction cost which I consider wasted costs to the system in the battles between insurers as to which policy shall respond.

Mr. FLORIO. You are not really relieving my apprehension, because I can foresee the insurance company in 1990 saying the problem occurred in 1985. The 1985 company saying the claim was filed in 1990.

Is it that clearcut how that is going to be resolved?

Mr. MAISONPIERRE. Yes it is, Mr. Chairman, and I think——

Mr. FLORIO. Well, what is the answer?

Mr. MAISONPIERRE. I think the best way would be for us to provide you with a line-by-line explanation, or for perhaps ISO to provide you with a line-by-line explanation of the policy and how that particular—how the policy insures that there will not be either an overlapping of contract, and that there is a very specific delineation as to which policy shall respond.

Mr. FLORIO. But let's assume for a moment that you are correct. And I assume that you are correct. How does that change the risk in any way such that people will become involved in insuring when one way or the other someone has got to pay on these long-latency disease occurrences, and that someone has got to calculate what it is going to cost, whether it be they calculate in 1985 for the policy year, or in 1990 when someone is going to issue a policy that is a claims-made policy knowing that retroactively they are going to have to be concerned about someone had worked in 1985 that may make a claim in 1990.

Mr. MAISONPIERRE. The policy provides that the claims-made policy can provide a certain degree of retroactivity in order to mesh with the policyholders existing occurrence policy. So that in 1985—1990, the policyholder—the insurance company will have a much closer, much better way to assess what the losses will be which will be filed against that policyholder in 1990.

Mr. FLORIO. How? When you are talking about 1990, you are calling upon an underwriter in 1990 to write a premium that may take into account the possibility of having been sued out of 1985. I mean, how is that any less nebulous or less subjective than is a prospective valuation of writing, the possibility you may be sued in 5 years from this point forward?

Mr. MAISONPIERRE. The claims-made policy provides that a policyholder may buy retroactive coverage. The date of retroactivity would be dependent upon the——

Mr. FLORIO. Ah, so you are talking about an extra add-on amount of coverage that if you don't take that then the claims made policy in no way provides you with protection back to 1985.

Mr. MAISONPIERRE. This, Mr. Chairman, is a fairly simple determination. The policyholder has to determine when his last claims-made policy expired.

Ms. WALTERS. May I help, if I can?

It is unfortunate Mr. Maisonpierre is being called upon to answer all the questions on the ISO policy.

I would like to leave this book with you because I think it will be very helpful in answering a lot of your questions.

But, with respect to what you were just speaking of, the intent and the purpose of having the new policy will be, take your situation in 1990, at that point we will be dealing with, and the underwriter who is providing the insurance to XYZ company will know what the current state of the art is with respect to scientific approaches and elements of causation.

Mr. FLORIO. By anticipating this great degree of stability in 1990.

Ms. WALTERS. Not necessarily stability, but at least in 1990 when you are evaluating this insured——

Mr. LENT. You are looking backward. In 1990 you are looking backward.

Ms. WALTERS. Not necessarily. You have the benefit of the growth in terms of what are the theories of recovery, what is the current legal environment in which claims are likely to be brought forth to this manufacturer, what has been the claims experience over the last 4 and 5 years as claims have come in under the claims-made policy.

Have they been for large amounts, have they been getting recoveries under new legal doctrines and what have those amounts been? What are the parameters? Can we estimate them a little better?

And I think what we are saying is, the full expectation is in 1990 all we have to evaluate are the claims that we expect to be brought forth to this particular insurer in 1990, and what will the value of those claims be.

We no longer have to evaluate, well, gee, what about incidence or injury or exposure that takes place in 1990 when there may be recovery 15 years later under a new scientific theory, or in fact under a new legal theory. That is the problem that we do away with and we are only dealing with the reality of that period of time.

Mr. FLORIO. The added coverage that was talked about, the extra add on, what does that——

Ms. WALTERS. The tail coverage, as Mr. Maisonpierre mentioned is—one of the things that makes this new claims-made form totally unique and different from any other claims-made product which is in the marketplace today—and I think that is one of the problems here, there are some claims-made policies being sold today for some types of coverage. This is entirely different because every claims-made policy that will be sold under the new form has the guaran-

teed right of an insured to purchase tail coverage if and when that insured needs it at the insured's option, not at the option of an insurance company.

So that when you have a situation where a person may be going out of business, or may want to change their type of coverage or anything, they have the right to buy tail coverage guaranteed in the policy to cover any injury that may have taken place during the term of the policy.

Mr. FLORIO. That seems to me to be not a particular right of any great significance, because no terms are written into it. You are liable to have the same situation you have here.

Ms. WALTERS. That's right.

Mr. FLORIO. That's a right that is nice, but not particularly significant.

Ms. WALTERS. But the reason that is written in there is because we don't want any gaps in coverage to take place.

Mr. FLORIO. The tail is prospective?

Ms. WALTERS. That's correct.

Mr. FLORIO. How about, the testimony that was there is in the claims policy the claims-now policy component in 1990 there will be a certain amount of retroactivity coverage as a result of the additional package.

What does that mean?

Ms. WALTERS. The way the claims-made form is designed, the policy period begins at the implementation date of the first claims-made policy. Let's say beginning in 1986 someone buys claims-made, and they continue buying claims-made policies for as long as they are in business. So, in 1990 that policy will cover any claim for damages during the policy period. The policy period being January 1, 1986, to and through 1990.

Mr. FLORIO. That presupposes the same company, though?

Ms. WALTERS. Not necessarily. Even if you switch companies, there is every expectation and likelihood that insurers will maintain the same retroactive date. And that retroactive date being the first date when you initially buy claims-made coverage.

Even if that doesn't happen, there are other provisions built in to protect the policyholder from any gaps in coverage.

Mr. FLORIO. Even though we are talking about different companies?

Ms. WALTERS. That's right.

Mr. MAISONPIERRE. It is my feeling that the claims-made policy will help on a short-term basis.

I think that as time elapses, I think that there may well be built up a retroactivity exposure which will create some problems. And I would frankly hope that in the intervening period that we could take a good objective look at that tort system—and I mean an objective look—and restructure the tort system so that the beneficiary of the tort system again becomes the accident victim. And I think this can be done.

Mr. FLORIO. Let me just conclude, because it has been a long day—just on a philosophical note.

You and the previous witnesses have asked for some action to deal with the liability system. There is legislation in the product

liability area that all advocate a national uniform standard toward questions of liability.

Do you feel that it is unreasonable, therefore, to say that we should perhaps have national uniform standards with regard to insurance regulations, so as to have this degree of uniformity so as to provide us with certainty, to provide the insurance industry with certainty, to provide the consumers with certainty under the judicial process as well as certainty under the regulation process?

Mr. MAISONPIERRE. I don't think that the two are—that the two must be placed on the same footing.

Mr. FLORIO. Why?

Mr. MAISONPIERRE. We, as an association, don't have any particular hangup about State or Federal government. We believe that what is important is that that level of government which can best control should be the one that should control the issue.

Mr. FLORIO. I agree with that 100 percent.

Mr. MAISONPIERRE. Insurance is basically a local problem. The policyholder is local, the legislature—the regulator can control the insurance environment within the particular State.

In product liability that is not so. Let's say, for instance, the State of New Jersey or the State of New York wanted to bring about a certain balance in the tort liability system. They would bring about certain changes in the system.

The New York State business people that export their product to Pennsylvania, Ohio, and what have you, would not be protected. And what you would be doing is that you would be controlling—the New York/New Jersey legislature would be controlling one end of the system but not the other, because to the extent that you have individuals in Ohio, Pennsylvania, California, being able to sue under a different system, there has been no protection brought about for New York/New Jersey industry.

Only the Congress can take care of this uniformity so as to bring about a proper balance between the business on the one hand and the consumers on the other.

Mr. FLORIO. I would just suggest to you that the industry should be very, very careful about advocating what it is they are advocating on national uniformity, because not everyone subscribes to your thoughts about the clear distinctions between desirable uniformity standards in one area of the problems associated with insurance, and no uniformity of standards in other areas associated with insurance.

It may very well be that someone may lose by winning. But I certainly appreciate your observations.

I would yield to the gentleman.

Mr. LENT. Thank you, Mr. Chairman.

Mr. Maisonpierre, Mr. Nader has quoted certain members of Lloyds of London as stating that they would not write reinsurance for the American casualty industry.

Are you familiar with those statements, and can you give us

your understanding of why it is that Lloyds' members might make such a statement?

Mr. MAISONPIERRE. Mr. Lent, our association only represents U.S. reinsurers and not Lloyds.

Mr. LENT. That's why I am asking you, because you can be completely nonpartisan because Lloyds is not a member of your organization, right?

Mr. MAISONPIERRE. I can tell you only what I read about Lloyds, but—what I suspect is occurring at Lloyds—and certainly from what I know about in some other European insurance companies that do provide extensive reinsurance in this country through U.S. subsidiaries; companies which are domiciled in the United States, regulated by the United States

Those are worldwide operations. Their investments in the United States may we be a rather limited amount of their total worldwide insurance and reinsurance operations. Yet, the losses which they have sustained in the U.S. market have been so atrocious as to totally dwarf any profit which they have made on their non-United States operations.

Today they are looking at the U.S. market and they are saying, why should the 12 percent of subtotal worldwide premium which we have invested in the United States, the 12 percent of premium which we are collecting from U.S. activities, why should that be used to wipe out almost totally the profits which we are making on worldwide operations.

Lloyds has said in a public hearing, that there is enough insurance needs to absorb all of its capacity in other European countries and the world. Why should they continue to invest in the United States when, in fact, the return is so abysmal.

I would have to say that it would be dramatic if this were to occur, because the U.S. reinsurance industry, as well as the U.S. primary industry needs Lloyds and needs Lloyds' market in order to spread the risks that we are exposed to.

Reinsurance is an international commodity and we are looking continuously at all world markets to be able to share the risk, the risk of loss, as broadly as possible.

Mr. LENT. You don't fault Lloyds then for making this threat?

Mr. MAISONPIERRE. I do not. I do not consider that a threat.

I think that Lloyds is recognizing the facts of life.

Mr. LENT. Is it Lloyds who is the stimulus behind this whole concept of introducing a claims-made policy to the American——

Mr. MAISONPIERRE. I believe Ms. Walters can answer that better than I can. I believe ISO started working on the claims-made policy about 7 or 8 years ago.

Mr. LENT. I can see Ms. Walters shaking her head yes, that Lloyds is not behind this. No conspiracy here.

Mr. MAISONPIERRE. Again, I am sure that Lloyds is a reinsurer and must look at the system the same way that we, in the U.S. reinsurance market are looking at it. They look upon this as a positive step in the U.S. casualty insurance market.

Mr. LENT. I have no further questions.

I thank the gentleman.

Mr. FLORIO. Mr. Maisonpierre, let me thank you very much for your patience through the course of the day. It has been a very productive hearing and you have contributed to that.

If there is no further business to come before the committee, the committee stands adjourned.

[Whereupon, at 3:25 p.m., the committee was adjourned.]

[The following statements and letter were submitted for the record:]

Submitted by the American Association of
Colleges of Nursing

The American Association of Colleges of Nursing (AACN) represents 383 college and university schools of nursing and approximately 8,000 full-time faculty. In serving the public interest, our organization exists to improve the practice of professional nursing through advancing the quality of baccalaureate and graduate programs, promoting research, and developing academic leaders. The AACN provides baccalaureate and higher degree programs in nursing with a framework through which issues critical to nursing can be considered and expeditiously acted upon.

We wish to address the current problem facing the nurse-midwifery community in retaining malpractice insurance. The practice of professional nursing has changed considerably during the past twenty years. Specialization is common, and nurse midwives have been pioneers in expanding the role of nurses into increasingly complex and responsible positions.

Nurse midwives work in private practices, hospitals, outreach centers, health maintenance organizations, and health departments. On July 3, 1985, the Mutual Marine Fire and Inland Insurance Company cancelled its policy covering 1400 of the American College of Nurse Midwives' (ACNM) 2600 members. 800 of the nurse-midwives covered by this policy are in private practice and will be forced to cease providing service without adequate coverage. The ACNM has been unable to obtain replacement insurance coverage for its members. General conditions in the insurance industry are the stated reasons for cancellation despite the very low rate of suits filed against nurse-midwives (6%).

This cancellation effectively jeopardizes the ability of nurse-midwives to practice their profession. Practicing a health profession without malpractice insurance during this litigious time is foolhardy. Even a careful practitioner who has acted prudently can be sued and must provide a defense. The loss of this cost-effective form of care to parents and babies is a loss that society cannot afford.

What is happening to the nurse midwives is an example of how a free marketplace can eliminate a useful societal product for unconvincing reasons. High percentages of suits brought against obstetricians should not be used against nurse-midwives. Without governmental intervention in the insurance issue, nurse-midwifery first and then probably other nurse specialties will fold. Society will lose this cost-effective, high quality alternative to more expensive medical care.

We urge Congress to take steps to intervene in this emergency situation. Providing funds for reinsurance or to assist the nurse-midwives to self insure would be helpful. Asking the states to enact laws mandating coverage of nurse midwives would be another useful approach.

Whatever approach is chosen, we urge you to consider the importance of consumers having a choice of providers and the idea that ~~an~~ occupation should not be restrained from practicing its trade. The colleges and schools of nursing around the country have educated these nurse-midwives, and urge the Congress to enable their former students to practice their profession.

STATEMENT

OF

INTERNATIONAL CHILDBIRTH EDUCATION ASSOCIATION

The International Childbirth Education Association (ICEA) is pleased to have this opportunity to present for the record its views on the availability and high cost of liability insurance.

The International Childbirth Education Association is an organization of approximately 12,000 members worldwide who support the philosophy and practice of maternity care that emphasizes pregnancy and birth as normal, healthy events with intervention used only for medical necessity. ICEA joins together health care providers and consumers who work toward "freedom of choice based on knowledge of alternatives," which is ICEA's motto.

Clearly, ICEA's area of expertise in the issues confronting this subcommittee today is limited to the effect of the cost of liability insurance for maternal health care providers, and its lack of availability for midwives and birthing centers, on the quality of maternal health care available to the childbearing public today.

Specifically, ICEA believes that the prohibitive cost of provider liability insurance and its lack of uniform availability for all maternal health care providers are restricting access to quality maternal health care and reducing the choices available to childbearing families.

The increase in malpractice lawsuits and the corresponding rise in malpractice insurance premiums are reducing the availability of birth attendants. A recent survey of obstetrician-gynecologists in Florida revealed that 25% had stopped attending births.1/ Many family practitioners are dropping their obstetric practice. In 1983, the Florida Academy of Family Practitioners reported that 44% of physicians surveyed planned to give up obstetrics.2/ Availability of midwives is reduced when they can no longer obtain obstetrical backup. Further restriction of health care provider options occurs when medical malpractice underwriters are unwilling to provide

obstetricians, certified nurse-midwives, and birth centers with liability insurance. In smaller communities women may be left with few birth alternatives for professional maternity care.

Access to quality maternity health care is further restricted by the increased costs resulting from fear of litigation. The significant rise in the number of procedures and tests used on pregnant women plus the escalating malpractice premiums which are passed on to the consumer increase the cost of having a baby.3/ Although data are imprecise, the American Medical Association estimated that the practice of defensive medicine in 1983 cost the American public $15.1 billion.4/ There are many in our society who do not have health care insurance which pays these bills. Still more have insurance which is inadequate to cover these costs. Increasingly, they are limiting their prenatal care, or eliminating it altogether, because they cannot afford to pay the bills.

ICEA's second concern is that childbirth choices are being greatly reduced. As malpractice claims become more frequent and settlements become higher, health care providers and hospitals become less flexible, interventions such as prenatal diagnostic testing and electronic fetal monitoring become routine, and parents have fewer options available. Seeking to be legally protected, health care providers are prescribing more and collaborating with clients less.

To cite just one statistical instance, cesarean section rates have been dramatically affected by the fear of malpractice litigation. According to the June, 1985 issue of the American Medical News, 36.3% of the 2,100 obstetricians surveyed by the California Medical Association have increased their use of cesarean section in response to the worsening liability environment in obstetrics.5/

A medical care system which fosters the idea that more technology means better health care tends to breed a society that uses litigation as the solution to a poor outcome. Health care consumers assume less responsibility for maintaining their own health and become more dependent on providers to do it for them. The unrealistic expectation by the public that all births will be perfect has been propagated by health care providers, educators hospitals, the legal system, and mass media. The result is a litigious society that assumes that a poor birth outcome is always the result of negligence.

Solutions to the malpractice situation are complex and will necessitate dedicated cooperation by all involved. Toward that end, in July, ICEA co-sponsored a Forum on Malpractice Issues in Childbirth: 1985 with the National Institute of Child Health and Human Development and the Division of Maternal and Child Health of the Department of Health and Human Services. The two-day Forum brought together a multidisciplinary group representing more than 75 major national organizations in medicine, midwifery, nursing, government, and health policy as well as the legal profession, third-party insurance carriers, malpractice underwriters, and childbirth and consumer health groups.

The participants were assigned to seven work groups, each comprising from 9 to 12 persons from different disciplines and backgrounds to provide a balance of viewpoints and areas of expertise. Each work group focused on a specific issue with the goal of developing recommendations and strategies for action. A copy of the Forum program is appended to this statement.

Of particular interest to this subcommittee are the recommendations of work group #3 which was charged with answering the following question: How can the government and its agencies prevent childbirth-related injury and reduce the adverse effects of malpractice claims? The recommendations developed by this work group at the Forum are presented below.

Recommendation No. 1: Governments should take immediate stop-gap measures to assure the availability of professional liability insurance for all licensed providers of maternal health care, including family practitioners, obstetricians, nurse-midwives, and birthing centers. To accomplish this objective, the following strategies were outlined: 1) The federal government should create a reinsurance fund that will fill the gap left in the private reinsurance market in the United States by the substantial withdrawal of private sector reinsurers. 2) All state governments should create joint underwriting associations of all insurance companies that write insurance in their states, and should require these associations to write insurance for the full spectrum of state-licensed maternal health care providers. The state joint underwriting associations should be reinsured by a national joint underwriting association created by federal legislation. 3) The federal government should authorize physician mutual insurance companies to underwrite malpractice insurance for other maternal health care providers.

Preamble to Recommendations No. 2 and No. 3: An important cause of the crisis in the availability and cost of malpractice insurance for maternal health care providers is the burdening of the malpractice insurance system and the tort system with social responsibilities that belong elsewhere. Recommendations No. 2 and 3 address the correction of this system fault.

The first responsibility that belongs elsewhere is the provision of social insurance for the cost of life-long care of severely disabled babies.

The second responsibility that belongs elsewhere is the policing of maternal health care providers to assure their competence and the quality of care they provide. The identification and discipline of maternal health care providers for incompetence, negligence, or impairment is probably the responsiblity of effective state licensing boards.

Recommendation No. 2: The social insurance of over 200 million Americans for catastrophic birth outcomes is now provided by the malpractice insurance premiums of approximately 50,000 maternal health care providers. This is much too small a base of persons to finance such a costly insurance program. Therefore, the government, as the agent of all the people, should provide catastrophic insurance for all disabled persons. This would eliminate the present necessity for all persons to use the tort system to attempt to get funding for the life-long cost of care for severely disabled babies, whether or not their disability is the result of malpractice. To accomplish this the following strategies were detailed: 1) The government should provide Medicaid entitlement with no means test to those with catastrophic disability. 2) At the same time the government should abolish the collateral source rule which now prevents revealing to the court and jury the other sources of compensation to the injured. This will enable juries to take into account the public insurance as well as other compensation to the injured in deciding the appropriate amount of court-awarded compensation.

Recommendation No. 3: There is a need to strengthen the governmental mechanism, especially state licensing boards, to assure the competence of health care providers. Strategies to accomplish this objective include: 1) Improve the flow of information regarding evidence of incompetence, bad practice, and maternal and childbirth accidents and injuries to state licensing boards by a) authorizing and encouraging anonymous reporting of such cases; b) requirng insurance companies to report all settlements and judgments in malpractice claims and suits; c) giving equal weight to complaints from consumers and providers; and d) widening and increasing the professional standards review of hospital and birth center maternal and neonatal medical records. 2) Strengthen state licensing boards by a) ensuring that members be

full time and compensated; b) providing adequate staff support; c) widening the representation on licensing boards to include substantial numbers of non-peers, such as consumers and providers from other health care disciplines; d) requiring speedy action on compliants and speedy resolution of disciplinary proceedings; and e) providing sufficient funding. 3) Create a nationwide clearinghouse to collect, catalog and make available evidence of provider incompetence and malpractice. The clearinghouse holdings should be accessible to all, including the general public, state governments and health care organizations.

Recommendation No. 4: State governments should take actions to maintain the availability of childbirth alternatives. Specifically this could be accomplished by 1) enacting legislation to require that, in court proceedings, maternal health care providers shall be judged by the standards of their particular health care discipline or profession (e.g., obstetricians by obstetrical standards, nurse-midwives by the standards of nurse-midwifery); and 2) taking actions as listed above to ensure the availability of malpractice insurance to the full spectrum of licensed maternal health care providers.

Recommendation No. 5: State governments should speed up the claims resolution process through general court reforms. Strategies for accomplishing this include: 1) the provision of specialized courts for medical malpractice suits, with judges who have some expertise in medicine; 2) the use of a computer-based system to improve court scheduling; and 3) the use of video-taped expert witnesses.

Recommendation No. 6: State governments should take measures to reduce the insurance companies' outlays for settlements without causing economic loss to the injured. The following strategies were developed to accomplish this recommendation: 1) the requirement of mandatory structured, or periodic,

payments for settlements above a legislatively specified dollar amount; and 2) the legislation of a sliding scale of attorney contingency fees.

Recommendation No. 7 (a minority recommendation): Much malpractice is criminal action, and, as such, should be tried in the criminal courts.

Other work groups at the Forum addressed the issues of how maternal health care providers, the public, medical malpractice underwriters, third-party insurance carriers and the legal system can prevent childbirth-related injury and reduce the adverse effects of malpractice claims. ICEA is currently publishing the Proceedings of the Forum on Malpractice Issues in Childbirth: 1985 which will include all the recommendations of the seven work groups. When the published Proceedings are available, ICEA will be pleased to supply a copy to the Subcommittee for the record. Extra copies can be ordered from the Director of Publications, International Childbirth Education Association, P. O. Box 20048, Minneapolis, Minnesota, 55420.

ICEA would be pleased to present to the Subcommittee any additional information which it can provide in an effort to seek resolution of this complex and far-reaching problem.

References

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3/ American College of Obstetricians and Gynecologists: Professional liability insurance and its effects: Report of a survey of ACOG's membership, Washington, D.C., Aug. 31, 1983.

4/ American Medical Association, Professional liability in the '80s. Report 1, Chicago, Oct. 1984.

5/ American Medical News: Liability situation altering obstetricians' practices: survey, June 21, 1985.

HELEN M. WOHLERT, RN, MSN

PRESIDENT

NAACOG: THE ORGANIZATION FOR OBSTETRIC, GYNECOLOGIC, AND NEONATAL NURSES

NAACOG, the organization for obstetric, gynecologic and neonatal nurses, is a specialty nursing organization which includes certified nurse midwives among its 18,000 members. These certified nurse midwives provide continuity of care for the pregnant woman by following them through the prenatal period, through delivery and into the post partum period. Many work with inner city and rural disadvantaged women who, without the certified nurse midwife, would not have this prenatal care. Other certified nurse midwives provide health care to women who have deliberately sought out this alternative to care by a physician.

The recent decision of insurance carriers to discontinue insurance for certified nurse midwives places the profession in jeopardy. Without adequate professional liability coverage, the certified nurse midwife cannot practice, nor can any nurse. All nurses need to have access to affordable insurance covering the areas of nursing practice for which they are responsible and accountable.

We are aware that, for the last two decades, malpractice claims have been increasing in frequency and that awards have escalated dramatically. However, the statistics of the American College of Nurse Midwives indicate that only 6% of certified nurse midwives have been named in a professional liability suit. By contrast, 60% of the obstetricians in this country have been sued. To lump these two groups together for statistical purposes is a distortion of the facts.

NAACOG Statement
Page 2

In addition to being available, insurance must be affordable. National statistics indicate that the average salary for the nurse midwife in the United States is $25,000. Obviously, insurance premiums on the scale of those for the medical profession are out of the question.

We recognize that health-care providers must work to ensure the quality in patient care. In fact, that is the purpose of NAACOG. But, we also feel that the time has come to address the twin problems of the availability and cost of professional liability insurance and the escalation of awards in malpractice suits.

NAACOG is pleased to learn that Chairman Florio and his Subcommittee on Commerce, Transportation, and Tourism is conducting a hearing on September 19, 1985 to look into these problems. Our membership applauds these efforts.

[illegible] F. LENT
4th District New York

COMMITTEE ON
MERCHANT MARINE AND
FISHERIES
RANKING REPUBLICAN

COMMITTEE ON ENERGY
AND COMMERCE

SUBCOMMITTEE
COMMERCE, TRANSPORTATION
AND TOURISM

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October 11, 1985

Honorable James J. Florio
Chairman
Subcommittee on Commerce,
Transportation, and Tourism
H2-151, House Office Building Annex #2
Washington, D.C. 20515

Dear Jim

I found the hearing concerning the problems facing the property-casualty insurance market, held by the Subcommittee on Commerce, Transportation, and Tourism on September 19, very interesting and informative. Enclosed you will find a letter from Mr. Charles Landgraf, U.S. General Counsel for the Underwriters at Lloyds of London, which comments upon that hearing. This letter provides an important perspective to some of the statements made at the hearing. Therefore, I request that this letter be made a part of the hearing record.

I understand that you intend to schedule additional hearings on this issue. To ensure that those who have an interest in this issue have an opportunity to be heard, I request that Lloyds of London and the National Association of Insurance Commissioners be invited to testify at the next hearing. Although I do not know if they will be able to testify, I believe it is imperative that they be given the opportunity to do so.

Thank you in advance for your consideration.

Sincerely yours,

Norman F. Lent
Ranking Minority Member
Subcommittee on Commerce,
Transportation, and Tourism

Enclosure

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ALBANY NY
NEWARK, NJ
EDISON NJ

October 1, 1985

The Honorable James J. Florio
Chairman, Subcommittee on
Commerce, Transportation and Tourism
Committee on Energy and Commerce
U.S. House of Representatives
Rayburn Office Building, Room 2162
Washington, D.C. 20515

Re: Hearings on Property/Casualty
<u>Insurance Industry -- September 19, 1985</u>

Dear Mr. Florio:

We wish to thank you for the September 11 letter invitation to appear at the Thursday, September 19, 1985 hearing which you extended to the Underwriters at Lloyd's, London, whom we are privileged to serve as U.S. General Counsel.

We hope that at some point in the near future it will be possible to arrange a mutually convenient meeting between you and a senior member of the Lloyd's underwriting community, if you remain interested in such a meeting.

In the meantime, we wish to take this opportunity to correct the record on some misstatements of fact regarding LLoyd's made at the September 19 hearing. We have not yet been able to obtain a transcript of the hearing from the Subcommittee Staff. Nevertheless, we attended the hearing, and from the prepared written testimony, our own notes of the oral remarks, and subsequent confirming press reports, it is clear that the record now contains several factually inaccurate statements by Ralph Nader, and Robert Hunter of the National Insurance Consumers Organization.

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October 1, 1985
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Mr. Hunter asserted that Lloyd's is not licensed as an insurer in any state in the United States and that no audited financial information is available in the U.S. on Lloyd's. These statements are incorrect. As Mr. Hunter should recall from his days as Federal Insurance Administrator. Lloyd's Underwriters are licensed insurers in three U.S. jurisdictions -- Illinois, Kentucky, and the U.S. Virgin Islands. Furthermore, Lloyd's Underwriters are accredited reinsurers and eligible surplus lines insurers in every other U.S. jurisdiction. Consequently, Lloyd's each year files audited financial statements with many states and with a number of Federal agencies, which also have recognized Lloyd's insurance and reinsurance.

Mr. Nader, for his part, grossly mischaracterized the recent public statements of Peter N. Miller, the Chairman of the Council of Lloyd's, and of another senior member of Lloyd's, Gerrold Wakefield, as "threats" to withdraw from the U.S. market. In fact, the speeches of both men were made in public forums in the United States in response to invitations by American sponsors. Chairman Miller was addressing a quarterly meeting of the National Association of Insurance Commissioners at their express request. Mr. Wakefield was speaking by invitation at an information gathering hearing organized by Illinois Insurance Director Washburn, and some dozen other state commissioners. The candid assessments of U.S. liability loss experience given by Chairman Miller and Mr. Wakefield are not only entirely appropriate, but also consistent with the evidence you received from domestic industry witnesses at the hearing.

Mr. Nader also urged your Subcommittee to investigate what he asserts was "lobbying and pressure on domestic . . . state regulators and lawmakers" by Lloyd's (Nader written statement). When pressed at the hearing for some substantiation, Mr. Nader alluded vaguely to events leading to Minnesota's amendment of its hazardous waste Superfund law a couple of years ago. In fact, contrary to Mr. Nader's innuendo, prior to the latter legislative development it was the Governor of Minnesota, Rudy Perpich, who sought Lloyd's Underwriter's counsel on the matter by traveling to London and visiting the Lloyd's Underwriting Room. Naturally, Underwriters cooperated with his request and expressed their frank views on the underwriting considerations posed by the then-existing terms of the statute.

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Finally, Mr. Nader created a similarly grave misimpression in his testimony by asserting that Lloyd's was the major initiator of the new comprehensive general liability policy form now being promoted by ISO and much of the domestic industry. In fact, the new CGL form has been a major project of ISO for many years, and it is only relatively recently, roughly the last twelve months, that ISO has even requested Lloyd's views on an already developed policy form. Representatives of Lloyd's have been forthcoming with their views, because they believe the U.S. market is of continuing importance, and interested Underwriters seek to remain, as they have always been, responsible participants in that market.

We hope that this information will be useful to you and the Subcommittee in the study of current problems in the U.S. property/casualty market. Of course, we will try to assist you and the Subcommittee should you have any further questions regarding Underwriters at Lloyd's.

Respectfully yours,

L. Charles Landgraf

L. Charles Landgraf

cc: The Honorable Norman F. Lent

LIABILITY INSURANCE AVAILABILITY

TUESDAY, FEBRUARY 4, 1986

HOUSE OF REPRESENTATIVES,
COMMITTEE ON ENERGY AND COMMERCE,
SUBCOMMITTEE ON COMMERCE,
TRANSPORTATION, AND TOURISM,
Washington, DC.

The subcommittee met, pursuant to notice, at 9:30 a.m., in room 2322, Rayburn House Office Building, Hon. James J. Florio (chairman) presiding.

Mr. FLORIO. The subcommittee will come to order.

Mr. Lent has been delayed. He has asked that we go forward in recognition of the time constraints that we have and the number of witnesses that we have this morning. I would like to welcome all in attendance.

This is the second in a series of hearings on the unavailability and unaffordability of liability insurance.

We convene in something of an atmosphere of crisis, as complaints flood into the Congress about insurance cancellations, large rate increases, and adverse effects on businesses and services.

Today's witnesses are on the frontlines of this crisis. Our witnesses include representatives of American businesses and of cities, towns, and school boards throughout the country. Many of the members of the groups represented have been hard hit by this crisis. The subcommittee is also pleased to welcome representatives of insurance agent organizations. Agents bring to these hearings both expertise about the insurance industry and knowledge of their clients' difficulties. The contribution of all our witnesses is greatly valued by this subcommittee.

To understand the implications of the liability crisis, we must learn of its impact on people such as those represented here today. Since insurance regulation has traditionally been a matter of State responsibility, an important aspect of our inquiry involves recent experience in the States. It is important for us to hear from those directly affected by the insurance crisis so we can see how State governments and the private sector might be able to solve the liability crisis.

As the debate regarding the insurance crisis unfolds, it increasingly appears the sources of our insurance difficulties are complex and diverse. State regulation, the judicial system, industry practices, and inadequate Federal enforcement of protections against health and safety hazards have all been cited as contributing to the crisis.

This complexity suggests that a solution to the crisis will require a higher degree of cooperation than is sometimes brought to bear in addressing controversial issues. The insurance crisis poses a serious economic threat. I hope that these hearings will contribute to a spirit of cooperation, because everyone has a stake in developing a consensus approach to a solution.

I would like at this point to yield to the gentleman from Iowa for any comments that he may have.

[The opening statement of Hon. Norman Lent follows:]

STATEMENT OF HON. NORMAN F. LENT

I want to commend the Chairman for convening this second hearing on the issue of availability and affordability of liability insurance. At our first hearing on this issue in September, 1985, we heard from a limited segment of the business community—such as hazardous waste management, day-care centers and nurse/midwives—concerning the problems they are encountering in obtaining insurance which is affordable. It appears that prospects for getting liability insurance are not any better in 1986. Lack of insurance is spreading to the business community in general and State and local governmental entities. Many have stated that the insurance problem is caused in large part by our civil justice system. Tort reform has been suggested as a possible solution to this problem. In my home State of New York, a commission has been established to study this problem and make recommendations.

I look forward to hearing from our witnesses today about their experiences both as insureds and as defendants in our tort system—and about their efforts to find solutions at the State level.

Mr. TAUKE. Well, thank you, Mr. Chairman.

I want to commend you for initiating hearings on the issue of liability insurance. During the past few months, as I have visited my home State of Iowa, the liability insurance problem has ranked right up there with the farm problem as being foremost in the concerns of my constituents. The problem crosses many boundaries. Obviously, we have great difficulties with liability insurance for professionals.

For example, a few weeks ago an obstetrician in from my home city of Dubuque came to my office to inform me that because his liability insurance premiums had topped the $40,000 mark, he was retiring at the age of 55. He had never had a claim against him but he found out that not only would he have to pay for this year the $40,000 insurance premium for his insurance, but he also would have to pay $67,000 tail if he retired today.

I have had a number of rural hospitals approach me because of their inability to find physicians who will perform certain services in those hospitals due to liability insurance problems. Skylifts in my district and a variety of other businesses, such as day care centers, have had difficulty in obtaining liability insurance.

I know Members of Congress have been approached, as I have, by a number of local officials who have watched the liability insurance for their units of government skyrocket. When I was in the Iowa Legislature we spent a lot of time talking about the liability insurance problem as it affected professionals, as it affected manufacturers, as it affected a variety of other interests in our society. But our basic conclusion all the time was that the Federal Government wasn't going to do anything, in fact, probably shouldn't do anything, and therefore, the State would move forward in this area.

As we speak today, legislatures all across the country are attempting to deal with the issue but it doesn't seem to me, after observing the development of this problem over a period of years, that we can any longer rely on the States to deal with this issue. If you have a manufacturer who is developing a product that will be sold across the Nation, a State-by-State approach isn't a very satisfying one. For those who are dealing with the problem on an ongoing basis, the State-by-State approach simply hasn't dealt with it in a satisfactory way.

So, it does seem to me it is time for the Federal Government to step in and to examine the issue and determine if there are some solutions that we can develop which can deal with it in a responsible way. Therefore, I commend the chairman for initiating these hearings.

I have no solution to offer at the moment and I don't have any particular approach that I think ought to be pursued, but like many, I am also committed to studying the question and trying to develop the most equitable solution available, one that will protect consumer interests and at the same time, protect the interests of the professionals and the manufacturers and others in the country, because ultimately by protecting their interests, we ensure that the services and the products they offer will be available to the consumers of this Nation.

Thank you, Mr. Chairman.

Mr. FLORIO. Thank you very much.

Mr. SHARP. Thank you, Mr. Chairman.

I am delighted to be here and want to thank the chairman for his continuing this series of hearings on liability insurance, because like my colleague from Iowa and the chairman of the committee, I am beginning to hear in a major way from constituents. Just in two town meetings last month, in small communities in Indiana, I heard from truckers, heard from oil jobbers, heard from local officials, from small farmers, about the growing problem of either getting coverage or astronomical increases in rates or just the general fear that they are not going to be able to cope with the dimensions of a clearly growing problem in this country.

So, I think it is both timely and imperative that we in Congress turn the spotlight on this problem to determine whether the focus has got to be on the legal profession and tort law, whether the focus has to be on the insurance industry, or whether the remedy has got to come from the States or from the Federal Government.

I don't yet know the answer among those contending forces and directions that we might go, and I think it is imperative that we get moving because my impression is the problem is not going to be diminishing but it is going to be clearly growing and at a bare minimum, it is of value for this committee and others in Congress to be focusing the spotlight in hopes that others might be able to solve the problem in the legal profession or in the insurance industry, but I am suspicious it is going to take a more dramatic effort in State and Federal legislatures, and I am delighted that the chairman is taking the issue up.

Mr. FLORIO. Thank you very much.

We are pleased to have as our first panel of witnesses, some very distinguished representatives of governmental entities. I would like

them to come forward. Mr. David Russell, first vice president, National Association of Towns and Townships; Mayor Francis Flaherty, Warwick, RI, National League of Cities; and Ms. Nellie Weil, first vice president, National School Boards Association. I welcome our witnesses to the subcommittee.

As with all of our witnesses for the morning, their statements will be put in their entirety in the record and the witnesses may feel free to proceed in summary fashion.

Mr. Russell, we would be pleased to hear from you.

STATEMENTS OF DAVID RUSSELL, FIRST VICE PRESIDENT, NATIONAL ASSOCIATION OF TOWNS AND TOWNSHIPS; FRANCIS X. FLAHERTY, ON BEHALF OF NATIONAL LEAGUE OF CITIES; AND NELLIE C. WEIL, FIRST VICE PRESIDENT, NATIONAL SCHOOL BOARDS ASSOCIATION

Mr. RUSSELL. Thank you, Mr. Chairman.

I hope you will forgive me for my voice. I have a terrible cold, but this was an issue that I definitely wanted to come down and testify on because it is very dear to our hearts, and is a serious problem in our State.

Mr. Chairman, members of the subcommittee, my name is David Russell. I am the first selectman, which is the New England equivalent of mayor, of the small town of Granby, CT. I am here today as the first vice president of the National Association of Towns and Townships, an organization representing over 13,000 predominant small rural governments around the Nation.

The vast majority of our constituency are under 25,000. I would guess that over 75 percent of our municipalities are under 5,000 population and that brings some very unique problems to us in responding to this insurance crisis. Many of the people who are in the leadership positions in our towns and townships are purely on a volunteer basis, on a part-time basis with no remuneration. Whatever they do, they do it as a service, and they are finding themselves in some serious governmental as well as personal liability questions, and as we all know, there have been problems growing in this country in volunteerism, the ability of people to have the time to volunteer, and when we add personal liability on top of some of the time problems that we have had in getting volunteers, it becomes a double edged sword, and we are having more and more problems getting people to run for office at the local level.

What I would like to do, we have submitted our testimony to you, in our written statement. I won't go over that. I would like to mention a couple of items to highlight what we consider the Federal role in alleviating the liability crisis.

I think the predominant role is probably at the State level and I brought with me the pile, a 50-page report that is being submitted to the Connecticut General Assembly tomorrow as a member of the Governor's Task Force in Connecticut on Insurance Availability and Cost. We have spent the last 6 months making recommendations, over 40 recommendations for changes at the State level.

There are a number of items, however, that even if these are solved at the State level, and some of them are going to be difficult issues to solve, they won't be terribly effective in some areas with-

out concomitant Federal action at the same time, because there are ways to go around the State courts if there are limitations or if there are some immunities granted at the State level. But they can go to the Federal courts the insurance companies tell us, and it does make some basic common sense if the same amount of money could be awarded in Federal courts or our insurance rates and our insurance availability is not going to change one iota.

Based on this concern, and some of the horror stories that I am sure that you have heard and read around the country in terms of either being cancelled, being nonrenewed, or having immense increases in premium costs, the National Association of Towns and Townships Board of Directors directed us to investigate this issue and we held a summit conference a couple of weeks ago in Washington, on the Federal role on liability insurance.

I think there are two roles I would like to talk about. One is section 1983, and the other is the problem of pollution insurance.

In section 1983, which is generally considered and had been since the 1800's, a civil rights section, I am sure you are aware that there has been a great change in the last several years in the interpretation and a number of suits filed under that section. Basically, it started out, from what I understand, practically the first 100 years of its existence there were only a couple hundred suits filed under it and it basically was for what we have always thought of as civil rights, in the narrow focus, violations.

In the last 10 years, there have been literally thousands of suits under this from everything from police to zoning matters and that has caused an immense amount of grief in the local governments and very difficult situations. None of us, I don't think, at the local level want to effect the civil rights impact of section 1983, but we do have some serious problems with the expansion and the wider interpretation given to that.

My own town has been sued under that and the recommendation from our attorney was that we settle what was in our opinion a ridiculous suit simply because the defense costs would have been larger than the suit was requesting. At least it wasn't one of the multimillion dollar suites. We did refuse to do that and finally, well, so far, we have won that, but it has been defended by the individual with no attorney and, therefore, very little if any costs to the plaintiff, and has gone through the U.S. Circuit Court.

We are waiting to see whether it is going to apply to the U.S. Supreme Court, and this is a case that involves probably something like $5,000. So far, it has cost us more than that to defend it. But it made a lot of sense to us because it was wrong. It was a bad suit in the first place and probably would have affected our insurance rates even more.

Also, Connecticut has the distinction of having the *Torrington* case, which has taken the police liability and put it on a very, very thin line, thinner than it ever was. We have had a number of cases in the past that talked about police overreaction to things. This is the first one that I am aware of that has come up with a police underreaction that resulted in a $2-million finding against the town because they didn't, the police didn't react enough to a request for help.

What we would urge you to do is some serious research, and we will certainly be happy to work with you in this for what we call a surgical remedy to section 1983. To carve out some of these areas that are being used now for the first time to claim civil rights violations that have nothing to do with the traditional civil rights concerns.

The second area is pollution. I know it varies from State to State. Certainly, in the State of Connecticut, virtually all of our towns have responsibility for waste disposal. My town has a landfill which has met our State Department of Environmental Protection Agency's regulations for years and years, but now we are told that we have no insurance and can get no insurance, and probably will not be able to get any insurance, and we have a frightening Jackson Township kind of liability that we are facing because of that.

We have never had a claim against our insurance company for pollution, but it is just simply a ticking time bomb. We are sitting there with no insurance, our elected board is probably personally liable. Even though we are indemnified under the State statute, there are lots of ways that people have gotten around that in the past.

Our dilemma is no matter how much we spend, no matter how many experts we bring in, no matter how many regulations we follow, nothing will indemnify us and they can come back to haunt us anytime in the future. We would suggest that the Federal Government look very seriously into acting as the insurer of last resort. We are caught between the proverbial rock and a hard place on pollution insurance.

The Environmental Protection Agency is telling us under Superfund that we must be insured. The insurance companies are telling us that we cannot be insured, and they will not insure us. Something has to give somewhere and perhaps the Federal Government, there are precedents for them to, in the Flood Insurance Program and the Riot Insurance Program, which I understand is as a matter of fact, the Federal Government even made a few dollars on, and if those precedents could be taken, and looked at, and tried to translate them over into this pollution area, it certainly would help us a great deal.

I would like to thank you very much for the opportunity to testify this morning. The National Association of Towns and Townships would certainly be willing to work with you in any way that we can to solve this.

[The prepared statement of Mr. Russell follows:]

TESTIMONY OF THE NATIONAL ASSOCIATION OF TOWNS AND TOWNSHIPS
BEFORE THE HOUSE COMMITTEE ON ENERGY AND COMMERCE
SUBCOMMITTEE ON COMMERCE, TRANSPORTATION AND TOURISM
TUESDAY, FEBRUARY 4, 1986

MR. CHAIRMAN AND MEMBERS OF THE SUBCOMMITTEE, I AM DAVID RUSSELL, EXECUTIVE DIRECTOR OF THE CONNECTICUT COUNCIL OF SMALL TOWNS, AND FIRST SELECTMAN OF THE TOWN OF GRANBY, CONNECTICUT. I AM TESTIFYING TODAY IN MY CAPACITY AS FIRST VICE PRESIDENT OF THE NATIONAL ASSOCIATION OF TOWNS AND TOWNSHIPS, AN ORGANIZATION REPRESENTING OVER 13,000 TOWNS, TOWNSHIPS AND SMALL GOVERNMENTS NATIONWIDE. THE VAST MAJORITY OF THE COMMUNITIES WE REPRESENT HAVE POPULATIONS UNDER 25,000 OFFICIALS IN LEADERSHIP POSITIONS RANGE FROM THOSE WHO HAVE BEEN ELECTED AND ARE ON A SALARIED BASIS, TO THOSE WHO ARE VOLUNTEERING THEIR TIME WITHOUT ANY REMUNERATION WHATEVER, AND WHO DO SO AS A SERVICE TO THEIR FRIENDS AND NEIGHBORS IN THE COMMUNITY.

MR. CHAIRMAN, WE APPRECIATE BEING INVITED TO TESTIFY HERE TODAY, AND WE FEEL THAT OUR TESTIMONY IS PARTICULARLY APPROPRIATE BECAUSE THIS CRISIS IN LIABILITY INSURANCE IS AFFECTING SMALL COMMUNITIES TO A GREATER DEGREE THAN OTHER GOVERNMENTAL UNITS -- BECAUSE WE HAVE LIMITED BUDGETS, WHICH MEANS THAT WE CANNOT SELF-INSURE, BECAUSE WE DON'T HAVE FLEXIBILITY IN THE REVENUE SOURCES THAT LARGER CITIES HAVE, AND BECAUSE SO MANY OF OUR LOCAL OFFICIALS ARE PART-TIME AND VOLUNTEERS, WE ARE MORE VULNERABLE TO HAVING THEM RESIGN FROM OFFICE. IN OTHER WORDS, WE CAN'T AFFORD THE CURRENT SITUATION -- WE CAN'T AFFORD THE ALTERNATIVES -- AND WE CAN'T AFFORD TO LOSE OUR LEADERSHIP.

WE HOPE THAT YOU WILL WORK WITH US AS WE STRUGGLE WITH THIS NATIONAL PROBLEM WHICH IS BECOMING MORE SERIOUS EVERY DAY AS CHANGES IN THE INSURANCE MARKETPLACE ARE PUTTING OUR MEMBERS MORE AND MORE AT RISK.

THE PARTICULAR CASE MOST OFTEN SINGLED OUT AS INFLUENCING THE CHANGES IN OUR CURRENT INSURANCE MARKETPLACE OCCURRED IN JACKSON TOWNSHIP, NEW JERSEY, IN 1983· A CASE WHICH HAS REVERBERATED CLEAR ACROSS THE UNITED STATES AND AS FAR AS LLOYDS OF LONDON. IT WAS IN JACKSON THAT 97 RESIDENTS CLAIMED THAT THEIR DRINKING WATER HAD BEEN CONTAMINATED BY CHEMICALS LEAKING FROM A LANDFILL WHICH HAD BEEN CLOSED YEARS EARLIER BY THE FEDFRAL ENVIRONMENTAL PROTECTION AGENCY.

THE CITIZENS WERE SUCCESSFUL IN THEIR LITIGATION, AND A JURY AWAROED THEM 15.8 MILLION DOLLARS -- LATER REDUCED TO 5.8 MILLION ON APPEAL. COMPANIES INSURING THE TOWNSHIP WERE FORCED TO PAY THE AWARD DESPITE THE FACT THAT THE POLICY THEY HAD ISSUED AMOUNTED TO ONLY ONE MILLION DOLLARS

AS A RESULT OF THE JACKSON TOWNSHIP CASE, ONE INSURANCE COMPANY IN PENNSYLVANIA CANCELLED THREE HUNDRED MUNICIPAL POLICIES IN THAT STATE ALONE. AND I WOULD LIKE TO POINT OUT, MR. CHAIRMAN, THAT OFTEN WE ARE FINDING POLICIES COMPLETELY CANCELLED WHETHER OR NOT THE MUNICIPALITY HAS EVER FILED A CLAIM.

OF COURSE THE JACKSON TOWNSHIP CASE IS NOT AN ISOLATED INSTANCE. EVERY DAY, TOWNS AND TOWNSHIPS ARE BECOMING FRUSTRATED AND FRIGHTENED BY THE ENORMITY OF THE CRISIS. OUR RESOURCES ARE BEING STRETCHED TO THE LIMIT AND IN MANY CASES -- ESPECIALLY WITH THE IMPLICATIONS OF GRAMM-RUDMAN-HOLLINGS AND THE REAL THREAT TO GENERAL REVENUE SHARING ALL COMING DOWN AT ONE TIME -- OUR VERY SURVIVAL AS AN ADEQUATELY FUNCTIONING UNIT OF GOVERNMENT IS IN QUESTION.

IN AN EFFORT TO COME TO GRIPS WITH THESE ISSUES, THE BOARD OF DIRECTORS OF THE NATIONAL ASSOCIATION OF TOWNS AND TOWNSHIPS DIRECTED AN INVESTIGATION INTO THE POSSIBILITIES FOR FEDERAL INVOLVEMENT IN RESOLVING THE SITUATION. AS A RESULT, ON JANUARY 14, 1986, WE CONVENED AND FACILITATED THE FIRST MEETING OF REPRESENTATIVES OF LOCAL, STATE AND FEDERAL GOVERNMENT, THE INSURANCE INDUSTRY AND OTHER PRIVATE SECTOR INTERESTS PARTICIPANTS IN OUR DAY-LONG "LIABILITY SUMMIT" INCLUDED REPRESENTATIVES FROM

WHITE HOUSE OFFICE OF INTERGOVERNMENTAL AFFAIRS
SENATE COMMITTEE ON ENVIRONMENT AND PUBLIC WORKS
HOUSE SUBCOMMITTEE ON COMMERCE, TRANSPORTATION AND TOURISM
OFFICE OF SENATOR PAUL SIMON
OFFICE OF CONGRESSMAN JOHN PORTER
U.S. DEPARTMENT OF JUSTICE
U.S. ENVIRONMENTAL PROTECTION AGENCY
CITY OF VIRGINIA BEACH, VIRGINIA
U.S. CONFERENCE OF MAYORS
NATIONAL ASSOCIATION OF COUNTIES
NATIONAL LEAGUE OF CITIES
NATIONAL CONFERENCE OF STATE LEGISLATURES
CONNECTICUT COUNCIL OF SMALL TOWNS
PENNSYLVANIA STATE ASSOCIATION OF TOWNSHIP SUPERVISORS
MARYLAND INSURANCE DIVISION
AMERICAN INSURANCE ASSOCIATION

PUBLIC RISK AND INSURANCE MANAGEMENT ASSOCIATION
NATIONAL INSURANCE CONSUMERS ORGANIZATION
NATIONAL RURAL ELECTRIC COOPERATIVE ASSOCIATION
NATIONAL SOLID WASTE MANAGEMENT ASSOCIATION
NATIONAL SHERIFFS ASSOCIATION
CRUM & FORSTER INSURANCE COMPANIES
GARDNER, MOSS AND HOPPER, ATTORNEYS-AT-LAW
ARNOLD AND PORTER, ATTORNEYS-AT-LAW
RISK SCIENCE INTERNATIONAL
RISK INSURANCE MANAGEMENT SOCIETY

THE THIRTY-FIVE PARTICIPANTS AT THE SUMMIT EXAMINED THE AVAILABILITY AND AFFORDABILITY OF INSURANCE, THE VULNERABILITY OF LOCAL GOVERNMENTS TO LAWSUITS UNDER FEDERAL ENVIRONMENTAL AND CIVIL RIGHTS STATUTES, AND POSSIBILITIES FOR FEDERAL ACTION TO SOLVE THE PROBLEMS.

WE FOCUSED ON SECTION 1983 OF THE CIVIL RIGHTS ACT OF 1871 AND ON FEDERAL ENVIRONMENTAL STATUTES, THE SOURCES OF MOST REQUIREMENTS, LITIGATION AND JUDGMENTS INVOLVING THE FEDERAL GOVERNMENT THESE ARE AREAS WHERE REMEDIAL ACTION BY STATE GOVERNMENTS IS NOT THE ANSWER, SINCE IF THERE IS A CAUSE OF ACTION AGAINST US IN EITHER SECTION 1983 OR THE ENVIRONMENTAL AREA, THE PLAINTIFFS CAN SUE IN FEDERAL COURT -- THEREBY OBVIATING DEALING WITH THE STATE COURTS. IN ESSENCE, WHATEVER THE STATES ARE DOING TO RESOLVE THE CRISIS -- AND MANY ARE VERY ACTIVE -- IT IS IMMATERIAL IN THOSE TWO AREAS, AND WE MUST LOOK TO THE FEDERAL GOVERNMENT FOR POSSIBLE SOLUTIONS.

THE ORIGINAL BASIS FOR SECTION 1983 WAS AS A HUMAN RIGHTS STATUTE RIGHT AFTER THE CIVIL WAR, WHICH ENABLED THE FEDERAL GOVERNMENT TO STEP IN UNDER THE 14TH AMENDMENT WHERE STATE LAWS WEREN'T BEING ENFORCED. IN THE FIRST HUNDRED YEARS OF THIS LAW THERE WERE APPROXIMATELY 200 SUITS FILED - BUT IN THE LAST YEAR, UNDER THIS LAW, THERE WERE

TWENTY-FOUR THOUSAND SUITS FILED, NOT INCLUDING SUITS FILED BY PRISON INMATES AGAINST THE STATE FOR ALLEGED CIVIL RIGHTS VIOLATIONS. MANY OF THESE TWENTY-FOUR THOUSAND LAW SUITS HAVE NOTHING WHATEVER TO DO WITH TRADITIONAL HUMAN RIGHTS. IF YOU DON'T LIKE, FOR INSTANCE, A LOCAL ZONING DECISION, SUITS HAVE BEEN ALLOWED UNDER SECTION 1983 ALLEGING THAT YOUR CIVIL RIGHTS HAVE BEEN INFRINGED. THIS INTERPRETATION OF SECTION 1983 HAS CAUSED A REAL EXPLOSION IN LITIGATION, PARTICULARLY SINCE THERE ARE NO CAPS ON EITHER ATTORNEYS FEES OR AWARDS IN THE FEDERAL COURT SYSTEM UNDER THIS STATUTE. ONE EXAMPLE, BROUGHT OUT AT THE SUMMIT, WAS A CASE WHERE A MUNICIPAL EMPLOYEE SUED FOR BACK PAY AND WAS AWARDED THE BACK PAY OF $1,500 -- WHICH WAS WHAT HE WANTED -- BUT THERE WERE $400,000 IN ATTORNEYS FEES.

THIS BRINGS US TO OUR FIRST RECOMMENDATION, MR. CHAIRMAN. WE FEEL VERY STRONGLY THAT IT IS IMPORTANT TO RESEARCH WHETHER THERE IS A CHANCE FOR A SURGICAL LEGISLATIVE REMEDY TO AMEND, IN A VERY NARROW FASHION, SECTION 1983 SO AS TO ABSOLUTELY AND COMPLETELY RETAIN THE CIVIL RIGHTS THRUST OF THE ORIGINAL LAW BUT REMOVE SOME OF THE NON-HUMAN RIGHTS CHALLENGES THAT ARE NOW FILED UNDER THE SECTION.

OF COURSE THERE IS A DANGER IN THIS THAT SUCH AN ACTION MIGHT BE CONSIDERED AN ASSAULT ON THE CIVIL RIGHTS LAWS OF THE UNITED STATES, AND THAT SHOULD NOT BE THE INTERPRETATION. WE STRONGLY SUPPORT RETENTION OF THE ENTIRE CIVIL RIGHTS THRUST OF SECTION 1983. IT IS POSSIBLE, HOWEVER, THAT LANGUAGE IN THE ORIGINAL STATUTE WAS NOT AS PRECISE AS IT MIGHT BE TODAY WHEN WE HAVE A MUCH BROADER HISTORICAL BASE IN CIVIL RIGHTS STATUTES.

WE HAVE STRONG CONCERN, MR. CHAIRMAN, ABOUT WHAT IS HAPPENING UNDER SECTION 1983. IT STRIKES US AS PART OF A CONTINUING ASSAULT ON THE STATUS OF LOCAL GOVERNMENTS AS PARTNERS IN THE FEDERAL SYSTEM SPECIFICALLY, AN INCREASING ATTEMPT, THROUGH

LEGISLATIVE AND JUDICIAL INTERPRETATION TO TREAT LOCAL GOVERNMENTS AS THOUGH THEY WERE SOME SORT OF BUSINESS. IT PRESUMES THAT LOCALITIES CAN RAISE THEIR PRICES TO DEAL WITH THE JUDGMENT -- PRICES, IN THIS CASE, BEING LOCAL TAXES -- AND THAT'S NOT ALWAYS THE CASE, BECAUSE OF MANY REQUIREMENTS AND CEILINGS OF STATE LAW. OR THAT THEY CAN WITHDRAW THEIR SERVICES, LIKE A BUSINESS COULD DO -- WHICH THEY ALSO CANNOT DO, BECAUSE THEIR SERVICE LEVELS ARE MANDATED BY STATE LAW, OR THAT THEY CAN GO BANKRUPT, WHICH THEY CANNOT DO.

WE FACE ESSENTIALLY THE SAME PROBLEMS IN THE POLLUTION ARENA. IN HAVING TO SCRAMBLE FOR ANY KIND OF INSURANCE PROTECTION THEY CAN FIND, MANY TOWNS AND TOWNSHIPS HAVE TO SETTLE FOR LIMITS ON COVERAGE -- HIGHER DEDUCTIBLES, LOWER PROTECTION LEVELS, AND EXCLUSIONS OF CERTAIN EXPOSURES, MOST OFTEN POLLUTION EXPOSURES.

THIS EXCLUSION OF POLLUTION COVERAGE IS OF PARTICULAR CONCERN TO THOSE MUNICIPALITIES WITH LANDFILLS. THE ENORMITY OF THE IMPENDING FINANCIAL DANGER BECOMES APPARENT WHEN YOU CONSIDER THE TREMENDOUS NUMBER OF OPERATIONAL AND PREVIOUSLY FUNCTIONING LANDFILLS ACROSS THE COUNTRY. FEDERAL MANDATES HAVE FORCED US TO ACCEPT THIS LIABILITY IN PERPETUITY AND HAVE LEFT US NO TOOLS TO DEFEND OURSELVES NO RESOURCES TO FALL BACK ON EXCEPT OUR SEVERELY STRAINED PROPERTY TAX BASE.

WE DO HAVE SEVERAL OTHER SUGGESTIONS THAT THE COMMITTEE MIGHT WANT TO CONSIDER, MR. CHAIRMAN. THE FEDERAL GOVERNMENT MIGHT PROVIDE INDEMNIFICATION IN THE WAY E.P.A. ALREADY DOES FOR ITS CONTRACTORS AT WASTE SITES. THEIR CONTRACTORS ARE INDEMNIFIED, BUT LOCAL GOVERNMENTS ARE NOT; AND INSURANCE COMPANIES HAVE INDICATED THEY CANNOT SEE A SITUATION WHERE THEY WILL REENTER THE ENVIRONMENTAL MARKET, BECAUSE EVEN SANITARY LANDFILLS POTENTIALLY ARE HAZARDOUS WASTE SITES -- SINCE HOUSEHOLD GARBAGE CONTAINS ALL SORTS OF TOXIC MATERIALS.

ANOTHER OPTION WE EXPLORED -- AND SOMETHING WE FEEL IS CRUCIAL TO THOSE OF US WHO ARE TRYING OUR BEST TO DO A GOOD JOB UNDER THESE EXTREMELY DIFFICULT CIRCUMSTANCES -- IS TO ESTABLISH FEDERAL STANDARDS OF COMPLIANCE IN THE ENVIRONMENTAL AREA, SO THAT A LOCAL GOVERNMENT WILL KNOW THAT IF IT DOES EVERYTHING THE STANDARDS REQUIRE IT WILL HAVE COMPLETE, OR AT LEAST LIMITED, PROTECTION. WITHOUT SUCH STANDARDS, NO MATTER WHAT WE DO -- NO MATTER HOW MUCH MONEY WE SPEND -- NO MATTER WHICH HIGH-PRICED CONSULTANTS WE ENGAGE OR HIGH-TECHNOLOGY EQUIPMENT WE PURCHASE -- NOTHING WILL REDUCE OUR LIABILITY UNDER THE ENVIRONMENTAL LAWS.

THE PRESSING, IMMEDIATE NEED FROM THE PERSPECTIVE OF THE NATION'S TOWNS AND TOWNSHIPS IS FOR CONSIDERATION OF FEDERAL INTERVENTION THAT WILL SOLVE THE LIABILITY PROBLEM AT LEAST FOR THE SHORT TERM, BRIDGING THE GAP WHICH EXISTS BETWEEN OUR PRESENT EXPOSURE AND OUR ABILITY TO PAY ENORMOUSLY INFLATED INSURANCE PREMIUMS. WE ALSO NEED CRISIS INTERVENTION BEFORE LOCALITIES ARE FORCED TO "GO BARE."

AS YOU KNOW, MR. CHAIRMAN, PRECEDENT EXISTS IN FEDERAL LAW FOR THE GOVERNMENT TO ACT AS INSURER OF LAST RESORT; WE FEEL STRONGLY THAT THAT OPTION DESERVES ANOTHER LOOK. AN OPPORTUNITY EXISTS NOW TO LEARN FROM THE MISTAKES OF THE FLOOD AND RIOT PROGRAMS OFFERED THROUGH H.U.D. AND THE CROP INSURANCE PROGRAMS OFFERED THROUGH U.S.D.A., AND TO DEVELOP DETAILS OF A PROPOSAL WHICH WOULD BE AN EFFECTIVE TOOL IN THIS ARENA. CLEARLY, PARTICULARLY UNDER THE PRESENT ECONOMIC SITUATION, SUCH AN INITIATIVE WOULD HAVE TO BE AS SELF-SUPPORTING AS POSSIBLE.

THERE ARE ALSO SOME SUGGESTIONS COMING FROM THE STATE LEVEL WHICH THE COMMITTEE MIGHT FIND VALUABLE. COMMON ELEMENTS APPEAR IN SEVERAL PROPOSALS OF WHICH WE ARE AWARE; THESE PARTICULAR EXAMPLES COME FROM THE EXPERIENCE OF THE STATES OF PENNSYLVANIA, OHIO AND MICHIGAN. IN MICHIGAN, THERE ARE BILLS CURRENTLY PENDING BEFORE THE LEGISLATURE, AND OHIO HAS RECENTLY ENACTED REMEDIAL LEGISLATION. THEY ALL CONTAIN OR ARE CONSIDERING PROPOSALS TO:

- -- ABOLISH OR AMEND THE DOCTRINE OF JOINT AND SEVERAL LIABILITY FOR GOVERNMENTAL UNITS;
- -- EXEMPT GOVERNMENTAL OFFICERS OR EMPLOYEES FROM LIABILITY WHILE ENGAGED IN THE PERFORMANCE OF THEIR DUTIES;
- -- MODIFY THE COLLATERAL SOURCE RULE i.e., A PROCEDURE BY WHICH THE COURT REDUCES THE JUDGMENT BY AN AMOUNT EQUAL TO PAYMENTS RECEIVED FROM GOVERNMENTAL BENEFITS, NO-FAULT INSURANCE AND OTHER SOURCES;
- -- CAP DAMAGES AWARDED FOR PAIN AND SUFFERING;
- -- PROVIDE FOR RECOVERY BY THE PREVAILING PARTY OF COSTS AND REASONABLE ATTORNEYS FEES, IF THE COURT FINDS THE ACTION TO HAVE BEEN FRIVOLOUS OR SOLELY FOR HARASSMENT.

ALSO UNDER CONSIDERATION CURRENTLY -- IN THE STATE OF MICHIGAN -- IS THE PRINCIPLE OF PROPORTIONAL LIABILITY: DETERMINATION OF A RELATIVE DEGREE OF FAULT BETWEEN ALL PARTIES THROUGH A FORMULA APPLIED BY THE COURT. IN THIS CASE, ALTHOUGH A LOCAL UNIT WOULD ALWAYS BE RESPONSIBLE FOR ITS PERCENTAGE OF FAULT, IT WOULD BE PROTECTED FROM THOSE WHO CONSIDER LOCAL GOVERNMENTS TO HAVE THE PROVERBIAL -- AND MYTHICAL -- "DEEP POCKETS," AND THEREFORE FAIR GAME AND TEMPTING TARGETS.

IN CLOSING, MR. CHAIRMAN, LET ME THANK YOU AGAIN FOR THE OPPORTUNITY TO TESTIFY THIS MORNING. WE ARE ALL IN THIS SITUATION TOGETHER AND ITS RESOLUTION IS OF VITAL CONCERN TO US ALL. CERTAINLY THERE IS AMPLE OPPORTUNITY FOR FURTHER EXPLORATION AND INVOLVEMENT AT THE FEDERAL LEVEL, AND THE NATIONAL ASSOCIATION OF TOWNS AND TOWNSHIPS WOULD LIKE TO WORK WITH YOU, YOUR STAFF AND MEMBERS OF THE COMMITTEE TO DEVELOP DETAILS OF A PROPOSAL WHICH WILL BE AN EFFECTIVE RESPONSE TO THIS NATIONAL CRISIS.

Mr. FLORIO. Thank you very much. Mayor Flaherty.

STATEMENT OF FRANCIS X. FLAHERTY

Mr. FLAHERTY. Thank you, Mr. Chairman.

Good morning, Mr. Chairman and members of the subcommittee. I am Francis X. Flaherty, mayor of Warwick, RI. I am testifying on behalf of the National League of Cities, which represents 15,000 cities through direct membership and membership in 49 affiliated State municipal leagues. I thank the chairman and the members of the subcommittee for this opportunity to testify today on the crisis in the availability and affordability of liability insurance.

I wish to focus this morning on the insurance crisis now facing cities and possible legislative solutions to that crisis. I will first review the causes of the insurance crisis and the dimensions of the problem. I would then like to suggest some legislative solutions to the insurance crisis which merit serious congressional consideration. I would like to make clear, however, at the outset that those proposals are primarily intended to establish a framework for a constructive debate by Congress as to the appropriate federal role and do not represent the final word on a solution.

Cities across America, because of cancellations of liability insurance policies and astronomic increases in premiums which sometimes are as high as 1,000 percent, are being forced to accept policies at great expense which provide only barebones coverage. In some cases, cities must eliminate or reduce services because insurance coverage has either been reduced or is no longer available. In other cases, cities have done the unthinkable, going bare and operating without insurance.

The de facto withdrawal of the insurance industry from the municipal market has created a major financial crisis for cities around the Nation. While cities grapple with the immediate, short-term problems of where to get insurance and how to pay for it, we must begin the search for answers to the larger question of finding long-term solutions to what is expected to be a recurring problem.

Developing consensus on a long-term solution which can be adopted by Congress requires an understanding of why the cities have been so severely and inequitably affected by the current crisis.

Problems in obtaining and affording municipal liability insurance in my own city of Warwick and in many other cities demonstrate the severity and magnitude of the disaster which has struck nearly every city in America.

In 1984, Warwick's insurance policy included general liability, umbrella, police, fire, and public official coverage and cost the city $137,000. That same policy, for which we received only renewal quote, would have cost $1 million in 1985, a year in which the city had budgeted $250,000 for insurance costs.

For the period March 1, 1982 through June 1, 1984, 53 claims totaling $175,000 were filed against the city. For the period June 1, 1984, through June 1, 1985, there were 11 claims totaling $46,000 filed against Warwick. Clearly, the city had not become an increased risk during that 1-year period.

Because of this prohibitive and unjustified increase in the cost of insurance, Warwick was forced to go bare for a 2-month period. The city was finally able to secure a limited policy providing general liability and umbrella coverage for $200,000. It cost $63,000 more than our 1984 policy, and more important, provided the city with only limited coverage. The essential functions of police and fire were left uninsured and public official liability was not covered. Our earlier policy had covered all five types of liability.

We were finally able to secure police coverage on July 1, 1985, only to be informed on November 14, 1985, that our policy was being canceled for underwriting reasons. Those reasons were never adequately described or explained to us.

Because the city has been without public official insurance since July 1, the city enacted an indemnification ordinance stating that the city would stand behind any municipal employee or public official who was sued. While we have requested assistance from the Governor, we have yet to receive a response.

Similar stories can be heard throughout the Nation. In nearby Maryland, insurance coverage was recently canceled in Frederick, Denton, North Beach, Elkton, and Chevy Chase Village. In Sykesville, a similar cancellation precipitated the resignation of the town's council president, two council members, and the entire board of zoning appeals. Cancellation of insurance in Bladensburg led to cessation of police services until coverage could be obtained.

In Wilmington, DE, the cost of municipal liability insurance increased 430 percent, while coverage was significantly reduced. In Dover, DE, the cost of liability insurance rose from $52,850 to $146,232, an increase of 300 percent. In Rehoboth Beach, DE, the cost went from $3,500 to $21,000.

In Dallas, TX, the cost of liability insurance increased 1,128 percent, even though the city had never filed a claim for reimbursement with the insurance company. The city found this increase unacceptable in light of its perfect record and elected to go bare. In Point Arena, CA, no bids were submitted even though the city requested bids from 30 companies, causing the mayor and members of the city council to resign.

All six members of the Antwerp, OH, City Council resigned after the village's insurance agent could not find a bidder on an insurance policy for the rural community of 1,800. Winston-Salem, NC, received a proposal involving an increase of 365 percent in the cost of its liability premium. It, too, decided to go bare.

The list goes on and on. While these examples of experiences at the local level are only a sampling of the problem, they are dramatic evidence of the stark choices facing local governments.

The insurance crisis is now affecting a broad cross-section of the economy. Insurance costs now make up the third largest category of expenses for Americans, trailing only food and housing costs and exceeding personal income taxes and health care costs as an expense. They now amount to more than $300 billion per year, or 12 percent of expenditures.

Municipal governments are unique in their dependence on tax dollars and their responsibility to provide public services. I know that you share our view that higher taxes, reduced services, or no insurance coverage are unacceptable alternatives.

There are two primary causes for the current insurance crisis:

First, the insurance market is cyclical in nature, periodically undergoing wide swings in behavior. Government intervention may be necessary to introduce greater stability in the market and to eliminate the extreme fluctuations. To date, neither the Federal Government nor State governments have undertaken such an effort.

Second, the recent expansion of tort liability has increased coverable losses and created great difficulties in predicting losses. Actions at the Federal and State level may be necessary to establish more certain ground rules and to clearly define and limit the circumstances in which a person should be considered financially liable for his or her actions.

The liability insurance industry, including the reinsurance market, is experiencing unprecedented losses and is in the midst of a financial crisis which is perhaps the worst in the history of commercial insurance. To a certain extent, the unavailability and unaffordability of insurance are a result of how the property and casualty insurance market functions.

The modern history of the property-casualty insurance business has been characterized by periodic and cyclical market fluctuations of varying intensity and duration. The alternation between "hard" or seller's market and "soft" or buyer's markets is generally referred to as the "underwriting cycle" in insurance industry parlance.

The high interest rates of recent years encouraged many insurers to rely on investment income, rather than on earnings from underwriting, for a positive year end performance. This practice, known as cash flow underwriting, has been subject to criticism by both financial experts and state regulators.

The hard market, the cash flow underwriting practice, and the scarcity of reinsurance have caused the industry to lose its capacity to underwrite high risk policies. When the reinsurance capacity shrunk and interest rates fell, the industry found that it expected to incur losses in the future which would be far in excess of foreseeable income.

The insurance industry has taken a number of steps to minimize its losses. These include restricting new business, reducing coverage, particularly for environmental and long range risks, changing from occurrence coverage to claims made coverage, increasing premiums, establishing higher deductibles, increasing the losses for which the insured is required to assume financial responsibility, and reducing the scope, amount and duration of coverage.

Another major step has been the complete withdrawal from markets which have been determined to be high risk. In some cases, such a decision means that the complete abandonment of the municipal market for particular insurance companies.

Municipal governments perform a variety of functions which cannot be carried out by the private sector. These functions frequently involve the balancing of risks and the need to make judgments as to which course of action is in the public interest.

Recent developments in tort law, the difficulty of risk assessment, and the underwriting cycle are three factors which explain why cities have been particularly and disproportionately impacted

by the current insurance crisis. And while other factors have contributed to the present crisis, it is generally recognized that the present insurance crunch is also a manifestation of problems in our judicial system.

The plight of local government is particularly serious because all residents of the municipality are affected, either by soaring insurance costs or by exposure to costly damage awards, if the Government cannot obtain insurance.

The recent fall in interest rates and accumulated problems caused by cash flow underwriting have coincided with a geometric increase in the number of lawsuits.

The majority of civil lawsuits are filed in State courts. Between 1978 and 1983, a record 12 million cases were filed. From 1940 to 1982 civil lawsuits in Federal courts increased sixfold, from 35,000 to 206,000. In 1984, one private civil lawsuit was filed for every 15 Americans. The number of lawsuits filed against public officials had doubled since 1982.

The size of damage awards are also up. In 1962, there was only one municipal liability case in the Nation in which a jury awarded $1 million. In 1983, there were 360 cases involving jury awards of at least $1 million, 13 times as many as in 1975. The current average award against U.S. cities has jumped from $230,000 in 1982 to $2 million in 1985.

The present tort system is not only costly for producers and manufacturers, but also inefficient. Studies have shown that lawyers receive more than the plaintiff recovers in a majority of cases. In asbestos litigation, for example, lawyers receive $62,000 of the average award or settlement of $101,000.

These increases in damage awards and the number of lawsuits are attributable to an increased propensity to sue, the establishment of stricter standards of care by the courts, increases in the cost of litigation, and the demise of the doctrine of sovereign immunity.

In addition the Supreme Court ruled the local governments could be sued under the Civil Rights Act of 1871, section 1983. With this decision, local governments were suddenly subject to a new form of liability, the nature and extent of which continues to be misunderstood and ill defined.

Although local governments have traditionally not been liable for the failure to act, courts have recently ruled that a failure to act can give rise to liability where a special duty or special relationship is found. The concept of negligent failure to maintain has been expanded to cover such matters as improper design, improvements, maintenance, or repair of public facilities, including streets and highways.

One recent example of the expansion of tort liability for municipalities illustrates just how unpredictable the law has become. A woman was attacked and taken to an abandoned factory owned by the city of Detroit where she was raped. She filed a lawsuit against the city, claiming that it knew or should have known that the factory was vacant and accessible for criminal activity and that it constituted an inherently dangerous condition. The lawsuit argued that the city should be liable for failing to secure the building, to

patrol or guard such premises, or to reduce the danger of the nuisance it had created.

The trial court dismissed the complaint. In a surprising decision, the appeals court reversed, based on the plaintiff's allegation that the city was aware that crimes were committed in abandoned buildings but failed to take action to secure them. This was deemed to be a sufficient basis for a lawsuit alleging that the building was a threat to public safety or an intentional nuisance.

The broader implications of this ruling are that: One, other cities may be forced to secure abandoned buildings under the intentional nuisance theory of inadequate security; and two, a wide range of governmentally owned facilities, including pedestrian walkways and tunnels, would become targets of inadequate security lawsuits under the nuisance theory.

In those cases where liability is found, responsibility for costs is frequently shifted to cities, even though some other party was primarily responsible for the damages. Courts in California and other States have, since the mid-1960s, steadily expanded the definition of who can be sued under the 100-year-old doctrine of joint and several liability.

Under this doctrine, each of the negligent parties is jointly and severally liable for the total amount of damages. Thus, when the actions of two persons have jointly caused injury, the plaintiff can collect damages from either or both persons regardless of relative responsibility. If one of the parties is not insured or is judgment proof, the other party must pay all the damages, even though the deep pock defendant may be minimally responsible.

Insurers blame such rulings and the continuing expansion of liability under similar theories for the average 650 percent rise in insurance premiums for cities and city officials. It is precisely this type of expansion in the assignment of responsibility under tort law that adds even more uncertainty to the measurement of expected future losses by insurers. In general, insurers, perhaps rightfully so, expect that losses for municipal governments will continue to grow by leaps and bounds. This expectation has had several effects on the kind of insurance policies that are offered to cities.

First, it increases insurance prices, with premiums rising to cover increased expected losses and the uncertainty caused by the inability to accurately estimate expected losses.

Second, companies attempt to limit their exposure to large losses by establishing outside limits on liability. In certain cases, some companies will go a step further, withdrawing from covering certain types of risk.

The uncertainty with regard to expected losses is best illustrated by recent developments in pollution insurance. The insurance industry is now refusing to provide insurance for a wide range of risks because of the inability to predict liability. Commercial insurance operates on the basis of the principle that, with sufficiently large numbers, a risk can be made predictable for using projections as to the likelihood of an accident. Unfortunately, the inability to make such projections in the environmental area and the potential size of damage awards in this area have made insurance companies unwilling to provide pollution insurance.

The insurance crisis is attributable to a number of recent developments in the insurance industry and in the American legal system. The only legislative approach which will work is a multifaceted attack on the problem. Approaching the problems on a piecemeal basis by, for example, revising State tort laws will be ineffective unless part of a comprehensive approach. Such a comprehensive approach must meet the dual objectives of restoring stability and fairness to the industry's pricing practices and the Nation's liability system.

Pricing practices in the insurance industry generally follow a cyclical pattern. They are as affected by financial trends outside of the insurance industry as by developments within the industry.

For example, the insurance industry underpriced insurance a few years ago during a period of high interest rates. The primary objective of this pricing practice was to generate revenues which could then be invested at the high interest rates. Underpricing was necessary because of competition among insurance companies for premium dollars to sue for investment purposes.

Interest rates are now substantially lower and, consequently, insurance companies no longer have the same financial interest in generating premiums for investment purposes. A consequence of this pricing practice is that insurance companies do not have a sufficiently large cushion of reserves to cover the costs of their insured risks and to maintain premiums at a low level.

At the same time as falling interest rates dramatically altered the pricing practices of the insurance industry, the Judicial and Legislative Branches of the Federal and State government have increased the potential liability of cities by expanding the rights of plaintiffs under the civil justice system. These legislative and judicial actions greatly increased the ability of individuals to be compensated for civil wrongs. If the defendant is insured, some or all of the costs of liability will generally be passed along to the insurer.

The pricing practices of the insurance industry are determined by national trends. In some cases, international trends may even have a significan. impact. Foreign insurance companies are major participants in the insurance market, a market which generally absorbs a relatively high proportion of losses. The liability explosion is, to a somewhat lesser extent, also attributable to developments at the national level where various Federal laws have added to the liability explosion.

Clearly congressional intervention is necessary to restore stability and certainty to the insurance industry and to limit the expansion of liabilit. The need for Federal intervention is further underscored by the breadth of the crisis, affecting, among others, State and local governments, mass transit systems, truck companies, doctors, nurses, day care centers, and bus companies.

Congress should undertake a complete review of the existing system of insurance regulation, revising any provision of law which is no longer effective. The framework for insurance regulation should be reviewed from top to bottom. We urge the consideration of the following proposals as a part of such a review process.

First, the Federal-State partnership should be strengthened by establishing minimum Federal requirements for the regulation of

the insurance industry, to be implemented at the State level and supplemented by additional State requirements.

Second, the antitrust exemption for the insurance industry and related Federal restrictions may no longer serve a useful purpose, and accordingly, should be reconsidered.

Third, Congress should consider the establishment of a federal reinsurance program for providers of essential services who cannot obtain insurance or afford to buy insurance in the conventional market.

Fourth, the market behavior and pricing practices of foreign insurance companies should be examined to determine whether Federal licensing requirements should be instituted.

Fifth, existing barriers which limit or preclude participation in the insurance market may need to be relaxed to draw new capital into the industry.

We urge Congress to give serious consideration to these proposals and other proposals that may be made today for reforming the regulatory framework. The magnitude of the crisis is such that all proposals for reform should be placed on the table for consideration.

One. Historically, the insurance industry has been regulated at the State level with very little Federal involvement. State regulators have generally been unable to respond to the current insurance crisis for a variety of reasons, including the lack of sufficiently broad statutory authority and the migratory nature of the insurance industry. The State regulators' problems have been further affected by the presence of a large number of insurance companies in each State and the variety of insurance needs and types of policies.

It is now time to strengthen the hand of State regulators by establishing minimum regulatory requirements which will be applicable in each State and will establish uniform national rules. These minimum requirements should limit incentives for States to compete for limited insurance dollars by lowering regulatory requirements in an effort to enhance the attractiveness of local markets to the insurance industry.

Minimum Federal requirements, however, should be implemented at the State level, thereby continuing the primacy of the States as insurance regulators. Furthermore, Federal requirements should serve only as minimums, whic[illegible] could then be supplemented by additional requirements determ[illegible] by the State to be necessary.

Finally, Federal requiren[illegible] ula be established only in those areas where uniformity w[illegible] engthen State regulation and where regulation is necessa[illegible] nsure the availability of insurance.

Examples of areas in which Federal minimum standards may be appropriate include the following:

To ensure more conservative underwriting practices, insurance companies could be required to file rates with the State insurance regulator a minimum amount of time before their effective date and to maintain those rates for a minimum amount of time.

To ensure availability of insurance, States could be required to establish assigned risk pools and to require insurers to provide coverage to participants.

States could be required to establish plans for returning excess profits where excess profits are determined on the basis of the dif-

ference between premiums and losses and earnings on investments are not counted in measuring profit to policyholders.

Cancellations of policies prior to expiration could be prohibited.

Insurers could be prohibited from not renewing policies unless the reasons for nonrenewal are specified and meet certain criteria.

Insurers could be prohibited from multiple cancellations of insurance contracts by type of coverage unless the insurer can document its adverse loss experience for the particular type of coverage and justify withdrawal from the market.

Insurance companies could be required to disclose loss data and other relevant data on a line by line basis to State regulators. Such information should enhance the State's ability to establish procedures and standards for the assessment of rate increases.

Insurance companies could be required to institute an experience rating system and to establish insurance rates on the basis of such a system.

These proposals are, for the most part, drawn from proposals now being considered for adoption in various States. They, and other similar proposals, should be carefully considered for the purpose of establishing a floor for insurance regulation at the State level.

Two. The insurance industry is, for the most part, exempt from the Federal antitrust laws under the McCarran-Ferguson Act, 15 USC sections 1011–15. Specifically, the Federal antitrust laws are not applicable to the business of insurance, to the extent that insurance is subject to State regulation. Despite the fact that State regulation of the insurance industry is, to a large extent, de minimus, it has been deemed to be sufficient to qualify virtually all insurance operations for the McCarran-Ferguson Act exemption. The only exception to this general rule is the boycott exception under which boycotts, coercion, or intimidation can be attacked on antitrust grounds.

Similarly, the Federal Trade Commission, generally charged with the responsibility of protecting consumers from unfair trade practices, is barred from studying the insurance industry under the FTC Improvements Act of 1980 unless specifically authorized by Congress to undertake such a study.

Local governments, on the other hand, are not exempt from the antitrust laws under the *Supreme Court's Community Communications Company, Inc.* v. *City of Boulder* ruling. Actions of local government may be challenged under the antitrust laws unless exempt under the state action exemption established by the Supreme Court in the *Parker* v. *Brown,* ruling. Thus, while Congress, in response to the *Boulder* ruling, has restricted the potential monetary liability of cities under the antitrust laws by its enactment of the Local Government Antitrust Act of 1984, cities may be enjoined from making basic governmental decisions under the antitrust laws.

Similarly, the FTC has asserted broad jurisdiction over State and local government regulatory activities. For example, it has underway a study on the effect of State and local regulation on competition. Recently it even went so far as to file complaints against the cities of Minneapolis and New Orleans in 1984 regarding the legality of the regulation of taxicab fares and limitations on the number

of taxicab medallions. An attempt by cities to secure enactment of an appropriations rider to preclude FTC actions against cities was initially successful in 1984, but the rider was repealed a few months later in exchange for enactment of the Local Government Antitrust Act.

Congress' unwillingness to exempt cities from the antitrust laws underscores the fact that antitrust exemptions are rarely granted by Congress and generally given only for the most compelling of reasons. Under this standard, it is indeed questionable whether the McCarran-Ferguson Act should remain in effect, particularly in light of the complete absence of competition which has developed recently in certain submarkets. Some risks are uninsurable at any price.

Congress should reassess the McCarran-Ferguson Act for the purpose of determining whether the insurance industry should retain its special antitrust status. Similarly, the authority of the FTC to study the insurance industry and to make policy recommendations should be restored.

The availability of reinsurance, under which a primary insurer may be insured for losses of a specified amount, determines whether risks are insurable. Generally, reinsurers operate on a national basis and are not regulated to any significant extent by the States. Because the McCarran-Ferguson Act's insurance exemption has been construed broadly, reinsurers are subject to virtually no regulatory restraints.

The reinsurance market absorbs a higher proportion of the losses than primary insurers and, as a result, determines the types of risks that are insurable. Its function is to spread risk and has reached into the international reinsurance market in an effort to spread the risk as far as possible.

The availability of reinsurance determines what types of risks are insurable and the cost of insurance. Thus, access to the reinsurance market determines whether cities can obtain insurance coverage. Because of the importance of reinsurance, Congress should consider the establishment of a Federal reinsurance program to guarantee insurance coverage for cities and high risk businesses.

Such a program was established by the Federal Government following the riots in the 1960's to make insurance available in inner city areas. Under the Urban Property Protection and Reinsurance Act, the Federal Government agreed to reinsure insurers against riots and civil commotions in return for a reinsurance premium and the insurer's participation in a pool to provide insurance for homeowners whose houses met specified minimum standards. While this program was strongly opposed by the insurance industry, it was successful, making money for the Federal Government and providing much needed insurance coverage in areas where the conventional market did not respond to basic needs.

The Urban Property Protection and Reinsurance Act serves as a useful model for the development of a broader program to address the insurance problems now facing cities and other high risk groups. It could be financed by the imposition of a surcharge on the gross receipts of the insurance industry. Eligibility criteria would have to be carefully devised to limit participation to the uninsurable. In addition to cities, the program could be used to address the

coverage problems for pollution, asbestos removal, day care, doctors, nurses, and commercial transportation.

Federal involvement in such a program is appropriate for several reasons:

First, the reinsurance industry operates on a national rather than a regional or local basis.

Second, the private sector has failed to serve the needs of cities and other providers of services which are essential to the operation of our economy and society.

Third, it will not necessitate the expenditure of general funds.

Fourth, various laws enacted by Congress are partially responsible for the insurance crisis.

Four Federal Laws—the Resource Conservation and Recovery Act, the Motor Carriers Act of 1980, the Comprehensive Environmental Response, Compensation and Liability Act of 1980, and the Bus Regulatory Reform Act—impose financial responsibility requirements. MCA, for example, mandates insurance coverage of from $1 to $5 million for vehicles of a certain size or vehicles which are used for the transportation of certain chemicals.

BRRA establishes similar requirements for buses, and RCRA and CERCLA impose requirements for waste treatment and storage facilities. Additionally, various Federal laws governing environmental and civil rights liability have contributed to the insurance crisis by expanding the liability of cities and other entities.

In addition to the Federal reinsurance program, consideration should be given to the establishment of licensing requirements for foreign companies providing reinsurance. Under current law, they are free to enter and withdraw from the American market as they see fit, greatly contributing to the instability of the reinsurance market and fluctuations in the availability of reinsurance. A licensing system could be established under which foreign participants in the reinsurance market would be subject to the penalties for withdrawing from the market.

The insurance industry has projected a large capacity shortfall for the next few years. Insurance industry reports indicate that, for every dollar received in premium payments in 1984, $1.18 was paid out in losses. Moreover, the insurance industry has estimated that demand exceeded the insurance industry's capacity by $7 billion in 1985 and may exceed supply by as much as $62 billion by 1987.

The insurance industry generally follows a rule, known as the Kenney formula, under which the premiums to surplus ratio is not allowed to exceed 3 to 1. This rule of thumb prevents insurers from becoming overcommitted when surpluses are low. The effect of this rule is that insurance coverage is saved for the best insurance risks during periods of limited supply. It will mean further limitations on the availability of insurance in the next few years.

Clearly this industry practice, in combination with the projected shortfall in the availability of funds, justify a reexamination of entry barriers to the insurance market.

Restrictions on entry into the insurance industry include Federal and State regulations barring bank participation in the market. If the bar is eliminated or relaxed, ground rules for bank participation in the insurance market should be devised which protect competition and the interests of both bank and insurance customers.

The capital capacity problems of the insurance industry may be sufficiently serious to justify relaxation of the entry barrier, creating a new source of capital for insurance.

The American system of civil justice is partially responsible for the crisis in the availability and affordability of insurance for cities. However, it is difficult to isolate any one factor as the primary cause of the explosive growth of liability. Moreover, many of the problems are due to developments at the State level where tort liability has been expanded and sovereign immunity has been eroded by State courts and legislatures.

In general, tort reform is the responsibility of State legislatures and courts. The system for redressing victims of wrongdoing is, for the most part, a creation of the States and, as a consequence, the States are primarily responsible for restoring balance to the civil justice system. However, there are certain areas where Congress can reduce the liability problems of cities and supplement the efforts now underway in various States to reform the system of tort liability.

First, the various proposals for reforming the tort liability system at the State level can be used as guidelines for the development of reforms in the Federal system.

Second, the Federal environmental laws should be examined to determine what reforms can be adopted without jeopardizing protections against pollution and similar problems.

Third, section 1983 of the Civil Rights Act of 1871 should be amended to preclude its use as a vehicle for bringing tort claims, which belong in State court, into Federal court.

The problems of the civil justice system at the State level have been enumerated on numerous occasions. The various proposals to reform the civil justice system would impose limitations on the rights of those who have been injured to recover damages. We present these proposals, not because we necessarily support them, but because they illustrate the difficult task facing state legislatures as they seek to balance competing interests.

One of the questions for Congress is whether the civil justice system is so out of control at the State level that Federal intervention is warranted. For example, a carrot and stick approach could be used to force States to reform their civil justice systems. We do not presently support such an approach because the states are making a major effort to address the most pressing liability problems and federal intervention would upset the existing Federal-State balance.

Among the proposals for reform of the civil justice system are the following:

Under this rule, evidence that the injured party has been or will be reimbursed from other sources is inadmissible. In cases in which money damages are awarded for economic loss, the effect of this rule is to enable plaintiffs to recover more than their economic loss. An example of the practical effect of this rule is that worker's compensation benefits cannot be considered in calculating how much the defendant should be required to pay the plaintiff for his or her economic loss.

Under this proposal, plaintiffs would no longer be allowed to recover unlimited damages for pain and suffering in addition to dam-

ages for actual economic harm. Pain and suffering, because it involves the consideration of intangible factors and difficult to measure costs, has frequently been the basis for the award of large judgments.

Under this proposal, the ability of plaintiffs to recover damages, which are awarded by the court for the purpose of deterring future illegal activities by the defendant or similarly situated persons, would be limited. Punitive damage awards may, in some cases, be disproportionately large in comparison to actual economic harm.

Under the joint and several liability theory, a defendant can be required to pay the total amount of damages, even though other parties were also responsible for the damages. For example, a city, found to be only 1 percent responsible for an injury to a person who is severely injured by a drunk driver, may be required to pay 100 percent of the damages. It makes no difference that the city's responsibility is minimal—a street sign warning of a curve in the road is partially obscured by a tree branch—and the codefendant's conduct is 99 percent responsible for the injury. Cities can be subject to liability under this theory as deep pocket defendants in a number of States, including California.

Proposals for revising this theory include the institution of a comparative liability system under which a defendant would be liable only for that portion of the damages which is attributable to his or her wrongdoing.

In some cases, attorneys recover more in attorneys' fees than the plaintiff recovers. This may be the result of contingency fee arrangements under which the plaintiff agrees that the attorney will receive a specified percentage of damages. Contingency fee arrangements have been criticized as a source of frivolous lawsuits which are brought because of the attorney's financial interest in the litigation.

In other cases, attorneys' fees exceed the amount of money received by the plaintiff because the cost of litigating the lawsuit was disproportionately high in comparison to the award of damages. Various proposals have been put forward in this area, including limiting contingency fees and narrowing the circumstances in which the plaintiff's attorney is allowed to recover attorneys' fees from the defendant.

Various environmental laws, including RCRA and CERCLA, are regarded by many as adding to the liability and insurance crises. The Superfund law, for example, applies the joint and several liability theory to owners and operators of waste sites. Similarly, the 1984 RCRA amendments required all land disposal facilities to comply with certain ground water and financial responsibility requirements by November 8, 1985, or close down their businesses. According to the Environmental Protection Agency, only 492 of 1,600 facilities were able to meet the deadline, with many facilities unable to satisfy the financial responsibility requirements of the law.

We do not raise these problems to suggest that these legal requirements should be eliminated. We know that they are intended to address longstanding problems and important public policy objectives. We would suggest, however, that Congress should provide the financial resources to clean up ground water contamination

and prevent pollution. The imposition of an insurance requirement is a useless palliative if insurance coverage is not available. Either the necessary financial resources must be provided or the legal standards relaxed.

Section 1983 was enacted shortly after the Civil War in 1871 for the purpose of preventing State and local governments from violating constitutionally protected rights. It has been misused by plaintiffs in recent years to bring state tort law claims into Federal court. By engrafting a tort claim onto the section 1983 claim, the plaintiff is able to circumvent the restrictions of State law, whether they be caps on damages or attorneys' fees or the defense of sovereign immunity.

Unless section 1983 is restored to its original purpose—the protection of civil rights—it will continue to be used as a vehicle for the adjudication of State tort claims in Federal court and will doom efforts to reform State tort laws to failure.

To a significant extent, the Supreme Court, in recent rulings, has begun to address some of these problems on a piecemeal basis. Congress should take similar steps, codifying these recent interpretations and making revisions and clarifications where appropriate.

First, section 1983 should be amended to make clear that a claim cannot be brought in Federal court if State law provides an adequate remedy for the redress of the plaintiff's grievance. Strict adherence to this rule would ensure the litigation of State tort claims in State court. The Supreme Court has fashioned generally a similar rule in *Parratt* v. *Taylor.*

Second, section 1983 should be amended to prohibit its use as a catchall cause of action for violations of Federal laws which were not designed to protect constitutional rights. The Supreme Court, several years ago, adopted a broad interpretation of section 1983, allowing plaintiffs to bring section 1983 actions for violations of Federal laws which had nothing to do with constitutional rights in *Maine* v. *Thiboutot.*

That rule was later swallowed by two exceptions adopted by the Supreme Court in *Middlesex County Sewer Authority* v. *National Sea Clammers Association.* Those two exceptions provide that a section 1983 claim cannot be brought for violation of a Federal statute if the statute itself provides a remedy or the Federal statute is regulatory in nature and not intended to create remedial rights.

Section 1983 should be revised to preclude its use as a catchall cause of action for violations of Federal statutes.

Third, section 1983 should be amended to prohibit the award of punitive damages against cities. In the *City of Newport News* v. *Fact Concerts,* the Supreme Court ruled that cities could not be subject to liability for punitive damages under section 1983. Section 1983 should be amended to incorporate this Supreme Court ruling.

Fourth, section 1983 should be amended to establish a specific statute of limitations. Under various court rulings, it has been determined that, since section 1983 does not include its own statute of limitations, statutes of limitations under State law governing personal injury should be used as a substitute—*Wilson* v. *Garcia.* The result is that the applicable statute of limitations varies from State to State, a somewhat illogical outcome. This needlessly com-

plex rule should be replaced with a uniform statute of limitations of 2 years.

Consumer organizations claim that the current crisis is manufactured by the insurance industry to increase profits and reduce victims' rights. The insurance industry blames a decade of price wars and two decades of increasing litigation for the current crisis.

We believe that a fundamental problem is the failure of the insurance industry to better manage its affairs and reduce the severity of profit-and-loss cycles that plague the property/casualty industry. In our view, it was poor management which led to cash flow underwriting practices and its accompanying decline of underwriting skills. In many respects, this is truly a crisis of the industry's own making.

The reasons for the current crisis at the municipal level have nothing to do with the loss experience of the particular government that is hit with an enormous increase in insurance costs or the cancellation of its insurance policy. Rather, the industry appears to have decided that all municipalities are bad risks.

Regardless of its causes, the current crisis in insurance is frighteningly real and dangerous. It has become increasingly clear that the insurance industry is not prepared or able to provide the solution.

The cyclical nature of the liability insurance industry suggests that the market could return to normal as early as next year as higher rates now in place replenish the industry's reserves. This prediction provides some measure of solace, but it reminds one of the farmer with a hole in the roof of the barn. The hole cannot be fixed while it is raining and there is no reason to fix it when it is not raining.

The soaring costs and unavailability of liability insurance strike at the very heart of municipalities and jeopardize the continued provision of essential public services. It is crucial that Federal, State, and municipal governments work together to cope with the current hard seller's market and the next one that will inevitably occur.

We urge Congress to consider our recommendations for changes in the applicable laws. It is essential that Congress establish a regulatory framework which reduces the fluctuations in pricing practices and guarantees the availability of insurance for providers of essential services. The current market is only an indication of how bad this crisis could become.

I thank the subcommittee for this opportunity to present our concerns today. We appreciate the difficult task before you and we trust that the needs and concerns of all American cities will be heard.

Thank you.

[Testimony resumes on p. 378.]

[Mr. Flaherty's prepared statement follows:]

Statement of

FRANCIS X. FLAHERTY

MAYOR, WARWICK, RHODE ISLAND

on behalf of

THE NATIONAL LEAGUE OF CITIES

Good Morning, Mr. Chairman and members of the subcommittee. I am Francis X. Flaherty, Mayor of Warwick, Rhode Island. I am testifying on behalf of the National League of Cities (NLC) which represents 15,000 cities through direct membership and membership in 49 affiliated state municipal leagues. I thank the Chairman and members of the subcommittee for this opportunity to testify today on the crisis in the availability and affordability of liability insurance.

I wish to focus this morning on the insurance crisis now facing cities and possible legislative solutions to that crisis. I will first review the causes of the insurance crisis and the dimensions of the problem. I would then like to suggest some legislative solutions to the insurance crisis which merit serious Congressional consideration. I would like to make clear, however, at the outset that these proposals are primarily intended to establish a framework for a constructive debate by Congress as to the appropriate federal role and do not represent the final word on a solution.

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INTRODUCTION

Cities across America, because of cancellations of liability insurance policies and astronomic increases in premiums (which sometimes are as high as 1000 percent) are being forced to "accept" policies at great expense which provide only barebones coverage. In some cases, cities must eliminate or reduce services because insurance coverage has either been reduced or is no longer available. In other cases, cities have done the unthinkable, going "bare" and operating without insurance.

The *de facto* withdrawal of the insurance industry from the municipal market has created a major financial crisis for cities around the nation. While cities grapple with the immediate, short-term problems of where to get insurance and how to pay for it, we must begin the search for answers to the larger question of finding long-term solutions to what is expected to be a recurring problem.

Developing consensus on a long-term solution which can be adopted by Congress requires an understanding of why cities have been so severely and inequitably affected by the current crisis.

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INSURANCE CRISIS

Problems in obtaining and affording municipal liability insurance in my own city of Warwick and in many other cities demonstrate the severity and magnitude of the disaster which has struck nearly every city in America.

In 1984, Warwick's insurance policy included general liability, umbrella, police, fire, and public official coverage and cost the city $137,000. That same policy, for which we received only one renewal quote, would have cost $1 million in 1985 (the equivalent of an 800 percent increase in one year), a year in which the city had budgeted $250,000 for insurance costs.

For the period March 1, 1982 through June 1, 1984, 53 claims totaling $175,000 were filed against the city. For the period June 1, 1984 through June 1, 1985, there were 11 claims totaling $46,000 filed against Warwick. Clearly, the city had not become an "increased risk" during that one-year period.

Because of this prohibitive and unjustified increase in the cost of insurance, Warwick was forced to go bare for a two-month period. The city was finally able to secure a limited policy providing general liability and umbrella coverage for $200,000.

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It cost $63,000 more than our 1984 policy and, more important, provided the city with only limited coverage. The essential functions of police and fire were left uninsured and public official liability was not covered. Our earlier policy had covered all five types of liability.

We were finally able to secure police coverage on July 1, 1985, only to be informed on November 14, 1985 that our policy was being cancelled for "underwriting reasons." Those reasons were never adequately described or explained to us.

Because the city has been without public official insurance since July 1, the city enacted an indemnification ordinance stating that the city would stand behind any municipal employee or public official who was sued. While we have requested assistance from the Governor (we contacted him over a year ago), we have yet to receive a response.

Similar stories can be heard throughout the nation. In nearby Maryland, insurance coverage was recently cancelled in Frederick, Denton, North Beach, Elkton, and Chevy Chase Village. In Sykesville, a similar cancellation precipitated the resignation of the town's council president, two council members, and the entire board of zoning appeals. Cancellation of insurance in Bladensburg led to cessation of police services until coverage could be obtained.

In Wilmington, Delaware, the cost of municipal liability insurance increased 430 percent, while coverage was significantly reduced. In Dover, Delaware, the cost of liability insurance rose from $52,850 to $146,232, an increase of 300 percent. In Rehoboth Beach, Delaware, the cost went from $. ,500 to $21,000.

In Dallas, Texas, the cost of liability insurance increased 1,128 percent, even though the city had never filed a claim for reimbursement with the insurance company. The city found this increase unacceptable in light of its perfect record and elected to go bare. In Point Arena, California, no bids were submitted even though the city requested bids from 30 companies, causing the mayor and members of the city council to resign.

All six members of the Antwerp, Ohio City Council resigned after the village's insurance agent could not find a bidder on an insurance policy for the rural community of 1,800. Winston-Salem, North Carolina received a proposal involving an increase of 365 percent i. the cost of its liability premium. It too decided to go bare.

The list goes on and on. While these examples of experiences at the local level are only a sampling of the problem, they are dramatic evidence of the stark choices facing local governments.

The insurance crisis is now affecting a broad cross-section of the economy. Insurance costs now make up the third largest category of expenses for Americans, trailing only food and housing costs and exceeding personal income taxes and health care costs as an expense. They now amount to more than $300 billion per year, or 12 percent of expenditures.

Municipal governments are unique in their dependence on tax dollars and their responsibility to provide public services. I know that you share our view that higher taxes, reduced services, or no insurance coverage are unacceptable alternatives.

Causes of the Current Crisis

There are two primary causes for the current insurance crisis.

First, the insurance market is cyclical in nature, periodically undergoing wide swings in behavior. Government intervention may be necessary to introduce greater stability in the market and to eliminate the extreme fluctuations. To date, neither the Federal Government nor state government has undertaken such an effort.

Second, the recent expansion of tort liability has increased coverable losses and created great difficulties in predicting losses. Actions at the federal and state level may be necessary to establish more certain ground rules and to clearly define and limit the circumstances in which a person should be considered financially liable for his or her actions.

1. The Hard "Seller's" Market

The liability insurance industry, including the reinsurance market, is experiencing unprecedented losses and is in the midst of a financial crisis which is perhaps the worst in the history of commercial insurance. To a certain extent, the unavailability and unaffordability of insurance are a result of how the property and casualty insurance market functions.

The modern history of the property-casualty insurance business has been characterized by periodic and cyclical market fluctuations of varying intensity and duration. The alternation between "hard" (or seller's) market and "soft" (or buyer's) markets is generally referred to as the "underwriting cycle" in insurance industry parlance.

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The high interest rates of recent years encouraged many insurers to rely on investment income, rather than on earnings from underwriting, for a positive year-end performance. This practice, known as "cash-flow underwriting," has been subject to criticism by both financial experts and state regulators.

The hard market, the cash-flow underwriting practice, and the scarcity of reinsurance have caused the industry to lose its capacity to underwrite high risk policies. When the reinsurance capacity shrunk and interest rates fell, the industry found that it expected to incur losses in the future which would be far in excess of foreseeable income.

The insurance industry has taken a number of steps to minimize its losses. These include restricting new business, reducing coverage (particularly for environmental and long range risks), changing from "occurrence" coverage to "claims made" coverage, increasing premiums, establishing higher deductibles (i.e., increasing the losses for which the insured is required to assume financial responsibility), and reducing the scope, amount, and duration of coverage.

Another major step has been the complete withdrawal from markets which have been determined to be high risk. In some cases, such a decision mean the complete abandonment of the municipal market for particular insurance companies.

2. The Expansion of Municipal Tort Liability

Municipal governments perform a variety of functions which cannot (or will not) be carried out by the private sector. These functions frequently involve the balancing of risks and the need to make judgments as to which course of action is in the public interest.

Recent developments in tort law, the difficulty of risk assessment, and the underwriting cycle are three factors which explain why cities have been particularly and disproportionately impacted by the current insurance crisis. And while other factors have contributed to the present crisis, it is generally recognized that the present insurance crunch is also a manifestation of problems in our judicial system.

The plight of local government is particularly serious because all residents of the municipality are affected, either by soaring insurance costs or by exposure to costly damage awards, if the government cannot obtain insurance.

The recent fall in interest rates and accumulated problems caused by cash-flow underwriting have coincided with a geometric increase in the number of lawsuits.

The majority of civil lawsuits are filed in state courts. Between 1978 and 1983, a record 12 million cases were filed. From 1940 to 1982, civil lawsuits in federal courts increased six-fold, from 35,000 to 206,000. In 1984, one private civil lawsuit was filed for every 15 Americans. The number of lawsuits filed against public officials has doubled since 1982.

The size of damage awards are also up. In 1962, there was only one municipal liability case in the nation in which a jury awarded $1 million. In 1983, there were 360 cases involving jury awards of at least $1 million, 13 times as many as in 1975. The current average award against U.S. cities has jumped from $230,000 in 1982 to $2 million in 1985.

The present tort system is not only costly for producers and manufacturers, but also inefficient. Studies have shown that lawyers receive more than the plaintiff recovers in a majority of cases. In asbestos litigation, for example, lawyers receive $62,000 of the average award or settlement of $101,000.

These increases in damage awards and the number ot lawsuits are attributable to an increased propensity to sue, the establishment of stricter standards of care by the courts, increases in the cost of litigation, and the demise of the doctrine of sovereign immunity.

In addition, the Supreme Court ruled in Monell v. Department of Social Services, 436 U.S. 658 (1978), that local governments could be sued under the Civil Rights Act of 1871, 42 U.S.C. Sec. 1983. With this decision, local governments were suddenly subject to a new form of liability, the nature and extent of which continues to be misunderstood and ill-defined.

Although local governments have traditionally not been liable for the failure to act, courts have recently ruled that a failure to act can give rise to liability where a "special duty" or "special relationship" is found. The concept of "negligent failure to maintain" has been expanded to cover such matters as improper design, improvements, maintenance, or repair of public facilities, including streets and highways.

One recent example of the expansion of tort liability for municipalities illustrates just how unpredictable the law has become. A woman was attacked and taken to an abandoned factory

owned by the city of Detroit where she was raped. She filed a lawsuit against the city, claiming that it knew or should have known that the factory was "vacant and accessible for criminal activity and that it constituted an inherently dangerous condition." The lawsuit argued that the city should be liable for failing to "secure the building, to patrol or guard such premises," or to reduce the danger of the nuisance it had created.

The trial court dismissed the complaint. In a surprising decision, the appeals court reversed, based on the plaintiff's allegation that the city was aware that crim ; were committed in abandoned buildings but failed to take action to secure them. This was deemed to be a suffi:ient basis for a lawsuit alleging that the building was a threat to public safety or an intentional nuisance.

The oroader implications of this ruling are that: (1) other cities may be forced to secure abandoned buildings under the intentional nuisance theory of inadequate security; and (2) a wida range of governmentally-owned facilities, including pedestrian walkways and tunnels, could become targets of inadequate security lawsuits under the nuisance theory. Sanford v. City of Detroit, No. 78049.

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In those cases where liability is found, responsibility for costs is frequently shifted to cities, even though some other party was primarily responsible for the damages. Courts in California and other states have, since the mid-1960's, steadily expanded the definition of who can be sued under the 100-year old doctrine of joint and several liability. Under this doctrine, each of the negligent parties is jointly and severally liable for the total amount of damages. Thus, when the actions of two persons have jointly caused an injury, the plaintiff can collect damages from either or both persons regardless of relative responsibility. If one of the parties is not insured or is judgment proof, the other party must pay all the damages, even though the "deep pocket defendant" may be minimally responsible.

The City of Signal Hill, California was ordered to pay $1.3 million because it restriped a street, increasing the number of lanes and reducing their width to 10 feet (the width accepted as legally safe by the California Department of Transportation). A motorcyclist traveling on the street many years later was injured when a car swerved in front of him.

South Tuscon, Arizona was ordered to pay more than $3 million to a police officer who was paralyzed as a result of being shot. The city originally filed for bankruptcy but ultimately agreed to fund a settlement package by selling bonds and city property.

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Los Angeles was ordered to pay a $1.7 million judgment in a case that arose when the brakes on an 11-year old boy's new bicycle failed and he lost control, crossing the street and striking an automobile head on. The city was sued because a bush on private property, on which the city apparently had an easement, allegedly prevented the boy and the driver from seeing each other.

Torrington, Connecticut, after being found liable for $2.6 million for the failure of the police to protect a woman from an attack by her estranged husband, lost its liability insurance.

In Newport Beach, California, the city was ordered to pay $6 million to a man who ran into the water at the beach, dove into the surf, and hit his head on a sand bar, suffering injuries which left him a quadriplegic. The jury determined that the city should have posted signs warning the public of the dangers created by the undulation of the ocean. San Diego's $25,000 settlement after a woman drowned in a riptide off a p. lic beach was cited as precedent. The plaintiff had argued that the city had a duty to inform swimmers of the natural hazard because it provided lifeguards during the swimming season (even through the accident occurred before the season began).

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Since that case was decided, four similar claims have been filed against the city. Shortly after the verdict, the city's insurance carrier cancelled its coverage.

Naming a government agency as a defendant in a lawsuit, no matter how tangential its involvement, brings a "deep pocket" defendant into the litigation who can pay the entire claim. The practical effect is that a city whose actions are only one percent responsible for the damages must pay 100 percent of the damages if the other defendant who is 99 percent responsible is judgment proof or uninsured. The taxpayers thus become the ultimate targets of municipal liability lawsuits.

Insurers blame such rulings and the continuing expansion of liability under similar theories for the average 650 percent rise in insurance premiums for cities and city officials. It is precisely this type of expansion in the assignment of responsibility under tort law that adds even more uncertainty to the measurement of expected future losses by insurers. In general, insurers, perhaps rightfully so, expect that losses for municipal governments will continue to grow by leaps and bounds. This expectation has had several effects on the kind of insurance policies that are offered to cities.

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First, it increases insurance prices, with premiums rising to cover increased expected losses and the uncertainty caused by the inability to accurately estimate expected losses.

Second, companies attempt to limit their exposure to large losses by establishing outside limits on liability. In certain cases, some companies will go a step further, withdrawing from covering certain types of risk.

The uncertainty with regard to expected losses is best illustrated by recent developments in pollution insurance. The insurance industry is now refusing to provide insurance for a wide range of risks because of the inability to predict liability. Commercial insurance operates on the basis of the principle that, with sufficiently large numbers, a risk can be made predictable by using projections as to the likelihood of an accident. Unfortunately, the inability to make such projections in the environmental area and the potential size of damage awards in this area have made insurance companies unwilling to provide pollution insurance.

LEGISLATIVE SOLUTION

The insurance crisis is attributable to a number of recent developments in the insurance industry and in the American legal system. The only legislative approach which will work is a multi-faceted attack on the problem. Approaching the problems on a piecemeal basis by, for example, revising state tort laws will be ineffective unless part of a comprehensive approach. Such a comprehensive approach must meet the dual objectives of restoring stability and fairness to the industry's pricing practices and the nation's liability system.

Insurance Reform

Pricing practices in the insurance industry generally follow a cyclical pattern. They are as affected by financial trends outside of the insurance industry as by developments within the industry.

For example, the insurance industry underpriced insurance a few years ago during a period of high interest rates. The primary objective of this pricing practice was to generate revenues which could then be invested at the high interest rates. Underpricing was necessary because of competition among insurance companies for premium dollars to use for investment purposes.

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Interest rates are now substantially lower and, consequently, insurance companies no longer have the same financial interest in generating premiums for investment purposes. A consequence of this pricing practice is that insurance companies do not have a sufficiently large cushion of reserves to cover the costs of their insured risks and to maintain premiums at a low level.

At the same time as falling interest rates dramatically altered the pricing practices of the insurance industry, the judicial and legislative branches of Federal and state government have increased the potential liability of cities by expanding the rights of plaintiffs under the civil justice system. These legislative and judicial actions greatly increased the ability of individuals to be compensated for civil wrongs. If the defendant is insured, some or all of the costs of liability will generally be passed along to the insurer.

The pricing practices of the insurance industry are determined by national trends. In some cases, international trends may even have a significant impact (Foreign insurance companies are a major participant in the insurance market -- a market which generally absorbs a relatively high proportion of losses). The liability explosion is, to a somewhat lesser extent, also attributable to developments at the national level where various federal laws have added to the liability explosion.

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Clearly Congressional intervention is necessary to restore stability and certainty to the insurance industry and to limit the expansion of liability. The need for federal intervention is further underscored by the breadth of the crisis, affecting, among others, state and local governments, mass transit systems, truck companies, doctors, nurses, day care centers, and bus companies.

Congress should undertake a complete review of the existing system of insurance regulation, revising any provision of law which is no longer effective. The framework for insurance regulation should be reviewed from top-to-bottom. We urge the consideration of the following proposals as a part of such a review process:

First, the federal-state partnership should be strengthened by establishing minimum federal requirements for the regulation of the insurance industry, to be implemented at the state level and supplemented by additional state requirements.

Second, the antitrust exemption for the insurance industry and related federal restrictions may no longer serve a useful purpose and, accordingly, should be reconsidered.

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Third, Congress should consider the establishment of a federal reinsurance program for providers of essential services who cannot obtain insurance or afford to buy insurance in the conventional market.

Fourth, the market behavior and pricing practices of foreign insurance companies should be examined to determine whether federal licensing requirements should be instituted.

Fifth, existing barriers which limit or preclude participation in the insurance market may need to be relaxed to draw new capital into the industry.

We urge Congress to give serious consideration to these proposals and other proposals that may be made today for reforming the regulatory framework. The magnitude of the crisis is such that all proposals for reform should be placed on the table for consideration.

1. Federal-State Regulation

Historically, the insurance industry has been regulated at the state level with very little federal involvement. State regulators have generally been unable to respond to the current

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insurance crisis for a variety of reasons, including the lack of sufficiently broad statutory authority and the migratory nature of the insurance industry. The state regulators' problems have been further affected by the presence of a large number of insurance companies in each state and the variety of insurance needs and types of policies.

It is now time to strengthen the hand of state regulators by establishing minimum regulatory requirements which will be applicable in each state and will establish uniform national rules. These minimum requirements should limit incentives for states to compete for limited insurance dollars by lowering regulatory requirements in an effort to enhance the attractiveness of local markets to the insurance industry.

Minimum federal requirements, however, should be implemented at the state level, thereby continuing the primacy of the states as insurance regulators. Furthermore, federal requirements should serve only as minimums, which could then be supplemented by additional requirements determined by the state to be necessary. Finally, federal requirements should be established only in those areas where uniformity would strengthen state regulation and where regulation is necessary to ensure the availability of insurance.

Examples of areas in which federal minimum standards may be appropriate include the follow ng:

- <u>"File and use."</u> To ensure more conservative underwriting practices, insurance companies could be required to file rates with the state insurance regulator a minimum amount of time before their effective date and to maintain those rates for a minimum amount of time.

- <u>Joint underwriting of assigned risks.</u> To ensure availability of insurance, states could be required to establish assigned risk pools and to require insurers to provide coverage to participants.

- <u>Excess profits.</u> States could be required to establish plans for returning excess profits (where excess profits are determined on the basis of the difference between premiums and losses and earnings on investments are not counted in measuring profit) to policyholders.

- <u>Cancellations.</u> Cancellations of policies prior to expiration could be prohibited (except for specified reasons such as non-payment of premiums fraud, etc.).

- Nonrenewal. Insurers could be prohibited from not renewing policies unless the reasons for nonrenewal are specified and meet certain criteria.

- Cancellations of policies by type of coverge. Insurers could be prohibited from multiple cancellations of insurance contracts by type of coverage unless the insurer can document its adverse loss experience for the particular type of coverage and justify withdrawal from the market.

- Disclosure of data. Insurance companies could be required to disclose loss data and other relevant data on a line-by-line basis to state regulators. Such information should enhance the state's ability to establish procedures and standards for the assessment of rate increases.

- Experience rating. Insurance companies could be required to institute an "experience rating" system and to establish insurance rates on the basis of such a system.

These proposals are, for the most part, drawn from proposals now being considered for adoption in various states. They -- and other similar proposals -- should be carefully considered for the purpose of establishing a "floor" for insurance regulation at the state level.

2. McCarran-Ferguson Act and Related Laws

The insurance industry is, for the most part, exempt from the federal antitrust laws under the McCarran-Ferguson Act, 15 U.S.C. Secs. 1011-1015. Specifically, the federal antitrust laws are not applicable to the "business of insurance" to the extent that insurance is subject to state regulation. Despite the fact that state regulation of the insurance industry is, to a large extent, de minimus, it has been deemed to be sufficient to qualify virtually all insurance operations for the McCarran-Ferguson Act exemption. The only exception to this general rule is the "boycott" exception under which boycotts, coercion, or intimidation can be attacked on antitrust grounds.

Similarly, the Federal Trade Commission (FTC), generally charged with the responsibility of protecting consumers from unfair trade practices, is barred from studying the insurance industry under the FTC Improvements Act of 1980 unless specifically authorized by Congress to undertake such a study. Pub. L. No. 96-252.

Local governments, on the other hand, are not exempt from the antitrust laws under the Supreme Court's Community Communications Company, Inc. v. City of Boulder ruling, 455 U.S. 40 (1982). Actions of local government may be challenged under the antitrust

laws unless exempt under the state action exemption established by the Supreme Court in the Parker v. Brown, 317 U.S. 341 (1943), ruling. Thus, while Congress, in response to the Boulder ruling, has restricted the potential monetary liability of cities under the antitrust laws by its enactment of the Local Government Antitrust Act of 1984, 15 U.S.C. Secs. 34-36, cities may be enjoined from making basic governmental decisions under the antitrust laws.

Similarly, the FTC has asserted broad jurisdiction over state and local government regulatory activities. For example, it has underway a study on the effect of state and local regulation on competition. Recently it even went so far as to file complaints against the cities of Minneapolis and New Orleans in 1984 regarding the legality of the regulation of taxicab fares and limitations on the number of taxicab medallions. An attempt by cities to secure enactment of an appropriations rider (Pub. L. No. 98-411) to preclude FTC actions against cities was initially successful in 1984, but the rider was repealed a few months later in exchange for enactment of the Local Government Antitrust Act.

Congress' unwillingness to exempt cities from the antitrust laws underscores the fact that antitrust exemptions are rarely granted by Congress and generally given only for the most compelling of

reasons. Under this standard, it is indeed questionable whether the McCarran-Ferguson Act should remain in effect, particularly in light of the complete absence of competition which has developed recently in certain submarkets. Some risks (e.g., asbestos abatement) are uninsurable at any price.

Congress should reassess the McCarran-Ferguson Act for the purpose of determining whether the insurance industry should retain its special antitrust status. Similarly, the authority of the FTC to study the insurance industry and to make policy recommendations should be restored.

3. Federal Reinsurance Program

The availability of reinsurance -- under which a primary insurer may be insured for losses of a specified amount -- determines whether risks are insurable. Generally, reinsurers operate on a national basis and are not regulated to any significant extent by the states. Because the McCarran-Ferguson Act's insurance exemption has been construed broadly, reinsurers are subject to virtually no regulatory constraints.

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The reinsurance market absorbs a higher proportion of the losses than primary insurers and, as a result, determines the types of risks that are insurable. Its function is to spread risk and has reached into the international reinsurance market in an effort to spread the risk as far as possible.

The availability of reinsurance determines what types of risks are insurable and the cost of insurance. Thus, access to the reinsurance market determines whether cities (and other businesses which the insurance industry has determined are high risk) can obtain insurance coverage. Because of the importance of re surance, Congress should consider the establishment of a federal reinsurance program to guarantee insurance coverage for cities and high risk businesses.

Such a program was established by the Federal Government following the riots in the 1960's to make insurance available in inner city areas. Under the Urban Property Protection and Reinsurance Act, 12 U.S.C. Sec. 1749bbb, 42 U.S.C. Sec. 4011, the Federal Government agreed to reinsure insurers against riots and civil commotions in return for a reinsurance premium and the insurer's participation in a pool to provide insurance for homeowners whose houses met specified minimum standards. While this program was strongly opposed by the insurance industry, it

was successful, making money for the Federal Government and providing much needed insurance coverage in areas where the conventional market did not respond to basic needs.

The Urban Property Protection and Reinsurance Act serves as a useful model for the development of a broader program to address the insurance problems now facing cities and other high risks groups. It could be financed, in the event that reinsurance premiums do not cover all costs, by the imposition of a surcharge on the gross receipts of the insurance industry. Eligibility criteria would have to be carefully devised to limit participation to the uninsurable (or those for whom insurance is prohibitively expensive). In addition to cities, the program could be used to address the coverage problems for pollution, asbestos removal, day care, doctors, nurses, and commercial transportation.

Federal involvement in such a program is appropriate for several reasons.

First, the reinsurance industry operates on a national rather than a regional or local basis.

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Second, the private sector has failed to serve the needs of cities and other providers of services which are essential to the operation of our economy and society.

Third, it will not necessitate the expenditure of general funds (It would be financed, if premium payments turn out not to cover losses, by the imposition of a surcharge or user fee on property and casualty insurers).

Fourth, various laws enacted by Congress are partially responsible for the insurance crisis.

Four federal laws -- the Resource Conservation and Recovery Act (RCRA), 42 U.S.C. Secs. 3001 et seq., the Motor Carriers Act of 1980 (MCA), 49 U.S.C. Secs. 3101 et seq., the Comprehensive Environmental Response, Compensation, and Liability Act of 1980 (CERCLA), 42 U.S.C. Secs. 9601 et seq., and the Bus Regulatory Reform Act (BRRA), 49 U.S.C. Sec. 10101 -- impose financial responsibility requirements. MCA, for example, mandates insurance coverage of from $1 to $5 million (depending on the size) for vehicles of a certain size (i.e., vehicles which are the size of a large pickup truck or larger) or vehicles which are used for the transportation of certain chemicals. BRRA establishes similar requirements for buses and RCRA and CERCLA

impose requirements for waste treatment and storage facilities. Additionally, various federal laws governing environmental and civil rights liability have contributed to the insurance crisis by expanding the liability of cities and other entities.

4. <u>Alien Reinsurers</u>

In addition to a federal reinsurance program, consideration should be given to the establishment of licensing requirements for foreign companies providing reinsurance. Under current law, they are free to enter and withdraw from the American market as they see fit, greatly contributing to the instability of the reinsurance market and fluctuations in the availability of reinsurance. A licensing system could be established under which foreign participants in the reinsurance market would be subject to penalties for withdrawing from the market.

5. <u>Entry Barriers</u>

The insurance industry has projected a large capacity shortfall for the next few years. Insurance industry reports indicate that, for every dollar received in premium payments in 1984, $1.18 was paid out in losses. Moreover, the insurance industry has estimated that demand exceeded the insurance industry's

capacity by $7 billion in 1985 and may exceed supply by as much as $62 billion by 1987.

The insurance industry generally follows a rule, known as the Kenney formula, under which the premiums-to-surplus ratio is not allowed to exceed 3-to-1. This rule of thumb prevents insurers from becoming over committed when surpluses are low. The effect of this rule is that insurance coverage is "saved" for the "best" insurance risks during periods of limited supply. It will mean further limitations on the availability of insurance in the next few years.

Clearly this industry practice, in combination with the projected shortfall in the availability of funds justify a reexaminiation of entry barriers to the insurance market.

Restrictions on entry into the insurance industry include federal and state regulations barring bank participation in the market. See e.g. 12 U.S.C. Sec. 1843. If the bar is eliminated or relaxed, ground rules for bank participation in the insurance market should be devised which protect competition and the interests of both bank and insurance customers. The capital capacity problems of the insurance industry may be sufficiently serious to justify relaxation of the entry barrier, creating a new source of capital for insurance.

Liability Reform

The American system of civil justice is partially responsible for the crisis in the availability and affordability of insurance for cities. However, it is difficult to isolate any one factor as the primary cause of the explosive growth of liability. Moreover, many of the problems are due to developments at the state level where tort liability has been expanded and sovereign immunity has been eroded by state courts and legislatures.

In general, tort reform is the responsibility of state legislatures and courts. The system for redressing victims of wrongdoing is, for the most part, a creation of the states and, as a consequence, the states are primarily responsible for restoring balance to the civil justice system. However, there are certain areas where Congress can reduce the liability problems of cities and supplement the efforts now underway in various states to reform the system of tort liability.

First, the various proposals for reforming the tort liability system at the state level can be used as guidelines for the development of reforms in the federal system.

Second, the federal environmental laws (and pending legislation) should be examined to determine what reforms can be adopted without jeopardizing protections against pollution and similar problems.

Third, section 1983 of the Civil Rights Act of 1871 should be amended to preclude its use as a vehicle for bringing tort claims which belong in state court into federal court.

1. State Tort Law Reform

The problems of the civil justice system at the state level have been enumerated on numerous occasions. The various proposals to reform the civil justice system would impose limitations on the rights of those who have been injured to recover damages. We present these proposals, not because we necessarily support them, but because they illustrate the difficult task facing state legislatures as they seek to balance competing interests.

One of the questions for Congress is whether the civil justice system is so out of control at the state level that federal intervention is warranted. For example, a "carrot and stick" approach could be used to force states to reform their civil justice systems. We do not presently support such an approach because the states are making a major effort to address the most pressing liability problems and federal intervention would upset the existing federal-state balance.

Among the proposals for reform of the civil justice system are the following:

- Eliminating or modifying the collateral source rule. Under this rule, evidence that the injured party has been or will be reimbursed from other sources is inadmissible. In cases in which money damages are awarded for economic loss, the effect of this rule is to enable plaintiffs to recover more than their economic loss. An example of the practical effect of this rule is that worker's compensation benefits cannot be considered in calculating how much the defendant should be required to pay the plaintiff for his or her economic loss.

- Capping or eliminating damages for pain and suffering. Under this proposal, plaintiffs would no longer be allowed to recover unlimited damages for pain and suffering in addition to damages for actual economic harm. Pain and suffering, because it involves the consideration of intangible factors and difficult to measure costs, has frequently been the basis for the award of large judgments.

- Limiting or eliminating punitive damages. Under this proposal, the ability of plaintiffs to recover damages, which are awarded by the court for the purpose of deterring future illegal activities by the defendant or similarly situated persons, would be limited. Punitive damage awards may, in some cases, be disproportionately large in comparison to actual economic harm.

- Limiting joint and several liability. Under the joint and several liability theory, a defendant can be required to pay the total amount of damages, even though other parties were also responsible for the damages. For example, a city, found to be only one percent responsible for an injury to a person who is severely injured by a drunk driver, may be required to pay 100 percent of the damages. It makes no difference that the city's responsibility is minimal -- a street sign warning of a curve in the road is partially obscured by a tree branch -- and the co-defendant's conduct is 99 percent responsible for the injury. Cities can be subject to liability under this theory as 'deep pocket" defendants in a number of states, including California.

Proposals for revising this theory (which does not apply in all states) include the institution of a "comparative" liability system under which a defendant would be liable only for that portion of the damages which is attributable to his or her wrongdoing.

- <u>Limitations on attorneys' fees.</u> In some cases, attorneys recover more in attorneys' fees than the plaintiff recovers. This may be the result of contingency fee arrangements under which the plaintiff agrees that the attorney will receive a specified percentage of damages. Contingency fee arrangements have been criticized as a source of frivolous lawsuits which are brought because of the attorney's financial interest in the litigation.

  In other cases, attorneys' fees exceed the amount of money received by the plaintiff because the cost of litigating the lawsuit was disproportionately high in comparison to the award of damages. Various proposals have been put forward in this area, including limiting contingency fees and narrowing the circumstances in which the plaintiff's attorney is allowed to recover attorneys' fees from the defendant.

2. Federal Environmental Laws

Various environmental laws, including RCRA and CERCLA, are regarded by many as adding to the liability and insurance crises. The Superfund law, for example, applies the joint and several liability theory to owners and operators of waste sites. Similarly, the 1984 RCRA Amendments required all land disposal facilities to comply with certain groundwater and financial responsibility requirements by November 8, 1985 or close down their businesses. 42 U.S.C. Sec. 3005 (e)(2). According to the Environmental Protection Agency, only 492 of 1600 facilities were able to meet the deadline, with many facilities unable to satisfy the financial responsibility requirements of the law.

We do not raise these problems to suggest that these legal requirements should be eliminated. We know that they are intended to address long-standing problems and important public policy objectives. We would suggest, however, that Congress should provide the financial resources to clean up groundwater contamination and prevent pollution. The imposition of an insurance requirement is a useless palliative if insurance coverage is not available. Either the necessary financial resources must be provided or the legal standards relaxed.

3. Section 1983

Section 1983 was enacted shortly after the Civil War in 1871 for the purpose of preventing state and local governments from violating constitutionally-protected rights. 42 U.S.C. Sec. 1983. It has been misused by plaintiffs in recent years to bring state tort law claims into federal court. By engrafting a tort claim onto a section 1983 claim, the plaintiff is able to circumvent the restrictions of state law, whether they be caps on damages or attorneys' fees or the defense of sovereign immunity.

Unless section 1983 is restored to its original purpose -- the protection of civil rights -- it will continue to be used as a vehicle for the adjudication of state tort claims in federal court and will doom efforts to reform state tort laws to failure.

To a significant extent, the Supreme Court, in recent rulings, has begun to address some of these problems on a piecemeal basis. Congress should take similar steps, codifying these recent interpretations and making revisions and clarifications where appropriate.

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First, section 1983 should be amended to make clear that a claim cannot be brought in federal court if state law provides an adequate remedy for the redress of plaintiff's grievance. Strict adherence to this rule would ensure the litigation of state tort claims in state court. The Supreme Court has fashioned a generally similar rule in Parratt v. Taylor, 451 U.S. 527 (1981).

Second, section 1983 should be amended to prohibit its use as a catch-all cause of action for violations of federal laws which were not designed to protect constitutional rights. The Supreme Court, several years ago, adopted a broad interpretation of section 1983, allowing plaintiffs to bring section 1983 actions for violations of federal laws which had nothing to do with constitutional rights in Maine v. Thiboutot, 448 U.S. 1 (1980).

That rule was later swallowed by two exceptions adopted by the Supreme Court in Middlesex County Sewage Authority v. National Sea Clammers Association, 453 U.S. 1 (1981). Those two exceptions provide that a section 1983 claim cannot be brought for violation of a federal statute if the statute itself provides a remedy or the federal statute is regulatory in nature and not intended to create remedial rights.

Section 1983 should be revised to preclude its use as a catch-all cause of action for violations of federal statutes.

Third, section 1983 should be amended to prohibit the award of punitive dama .s against cities. In City of Newport News v. Fact Concerts, 101 S.Ct. 2748 (1982), the Supreme Court ruled that cities could not be subject to liability for punitive damages under section 1983. Section 1983 should be amended to incorporate this Supreme Court ruling.

Fourth, section 1983 should be amended to establish a specific statute of limitations. Under various court rulings, it has been determined that, since section 1983 does not include its own statute of limitations, statutes of limitations under state law governing personal injury should be used as a substitute, Wilson v. Garcia, 53 U.S.L.W. 4481 (1985). The result is that the applicable statute of limitations varies from state to state, a somewhat illogical outcome. This needlessly complex rule should be replaced with a uniform statute of limitations of two years.

CONCLUSION

Consumer organizations claim that the current crisis is manufactured by the insurance industry to increase profits and reduce victim's rights. The insurance industry blames a decade of price wars and two decades of increasing litigation for the current crisis.

We believe that a fundamental problem is the failure of the insurance industry to better manage its affairs and reduce the severity of profit and loss cycles that plague the property/casualty industry. In our view, it was poor management which led to cash-flow underwriting practices and its accompanying decline of underwriting skills. In many respects, this is truly a crisis of the industry's own making.

The reasons for the current crisis at the municipal level have nothing to do with the loss experience of the particular government that is hit with an enormous increase in insurance costs or the cancellation of its insurance policy. Rather, the industry appears to have decided that all municipalities are bad risks.

Regardless of its causes, the current crisis in insurance is frighteningly real and dangerous. It has become increasingly clear that the insurance industry is not prepared or able to provide the solution.

The cyclical nature of the liability insurance industry suggests that the market could return to normal as early as next year as higher rates now in place replenish the industry's reserves. This prediction provides some measure of solace, but it reminds one of the farmer with a hole in the roof of the barn: the hole cannot be fixed while it is raining and there is no reason to fix it when it is not raining.

The soaring costs and unavailability of liability insurance strike at the very heart of municipalities and jeopardize the continued provision of essential public services. It is crucial that federal, state, and municipal governments work together to cope with the current hard "seller's" market and the next one that will inevitably reoccur.

We urge Congress to consider our recommendations for changes in the applicable laws. It is essential that Congress establish a regulatory framework which reduces the fluctuations in pricing practices and guarantees the availability of insurance for providers of essential services.

The current market is only an indication of how bad this crisis could become. I thank the subcommittee for this opportunity to present our concerns today. We appreciate the difficult task before you and we trust that the needs and concerns of all American cities will be heard.

Thank you.

Mr. FLORIO. Thank you very much, Mayor.
Mr. FLAHERTY. Thank you, Mr. Chairman.
Mr. FLORIO. Ms. Weil.

STATEMENT OF NELLIE C. WEIL

Ms. WEIL. I am Nellie C. Weil, first vice president of the National School Boards Association. I am pleased that we can submit this testimony to the House Subcommittee on Commerce, Transportation and Tourism. The National School Boards Association is the only major education organization representing school board members who govern the Nation's public school districts. Throughout the Nation, approximately 95,000 of these individuals are association members. These people, in turn, are responsible for the education of more than 95 percent of the Nation's public school children.

Currently marking its 46th year of service, National School Boards Association is a federation of State school board associations, with direct local school board affiliates, constituted to strengthen local lay control of education and to work for the improvement of education. Most of these school board members are elected public officials. Accordingly, they are politically accountable to their constituents for both education policy and fiscal management. As lay unsalaried individuals, school board members are in the rather unique position of being able to judge legislative programs purely from the standpoint of public education, without consideration to their personal or professional interest.

Over the past year and a half, local school districts, not unlike other units of State and local government, have found themselves in the legally precarious position of operating absent any insurance coverage, with inadequate insurance coverage or, with adequate insurance at significantly increased premium rates.

Reports from National School Boards Association members indicate that this is not a regional phenomenon. Rather, school districts across the Nation have found themselves in the unenviable position of providing a myriad of services which no prudent business would offer without adequate insurance coverage in effect.

The full range of services school districts are involved in—both to students and to the community at large—often require five basic types of insurance coverage in effect. Those are:

First, fleet insurance. School districts are required by law to provide adequate transportation, from central locations, to and from the school grounds on a daily basis. In many rural districts, this often means transporting children over 100 miles per day, over two-lane mountain passes in adverse weather conditions.

In the case of many of our handicapped children, school districts must provide adequate transportation from the door of the child's home to the school.

Finally, all field trips, sporting events, and group activities require that school districts provide bus service on a roundtrip basis originating at the school.

Second, general tort liability. School district buildings and groups are open to the general public on a service and on a use basis. In fact, the Nation's local school districts provide onsite service to more Americans each year than any other unit of Federal, State,

or local government. Because this is so and, given the myriad of services school districts provide, tort liability policies must be crafted to meet any eventuality, from a broken arm resulting from a fall on the stairs to an explosion in the chemistry laboratory. Moreover, policy coverage must extend not only to students, school districts personnel and guests, but also to the public at large, who routinely utilize school district facilities such as gymnasiums, cafeterias, and playing fields for social and sporting events.

Third, workmen's compensation. In those States which do not provide uniform State plans for workmen's compensation but do mandate such coverage, school districts are required to obtain coverage for each employee from the marketplace. School district personnel includes, but is not limited to, teachers, other professional staff, cooks, janitors, cafeteria workers, bus drivers, plant engineers, physicians, nurses, groundskeepers, shop and maintenance engineers.

Fourth, errors and omissions. School board members, like all elected officials, are susceptible of misfeasance and malfeasance litigation in their official capacity. For an elected official to continue to serve in their official capacity absent errors and omissions coverage places their personal holdings at risk, thus jeopardizing their family and their business.

Fifth, catastrophe umbrella coverage. This coverage is deemed essential as a supplement to all other policies for several reasons. First, because school districts provide services to large groups in restricted areas, the likelihood that one event would cause serious injury to more than one individual is greatly increased in the school setting.

Second, and again because of the large number of people school districts are responsible for, it is not improbable that several unrelated accidents could occur which in their aggregate would exceed the face amount of any basic policy.

First, cancellation without cause. Since 1984, many school districts across the country have had their insurance policies canceled with no explanation. For instance, in my own school district of Montgomery, AL, our insurance carrier canceled all of our policies absent prior notice or explanation. This cancellation was not the result of excess claims, in fact, as a member of the Montgomery County School Board, I can testify to the fact that not one judgment was entered against my district during my 12 years of service on the board.

Cancellations without cause became the norm and not the exception in Alabama in 1985. Fortunately, Alabama has no State law precluding the formation of insurance pools, although there was no law allowing such a formation. Through our State association of school boards, we in Alabama asked for and received a State attorney general opinion which permitted our school districts to form an insurance pool. Our pool is structured to pick up all losses up to $500,000 and the pool was fortunate to locate excess coverage from Lloyds of London. However, we have no assurances that our excess coverage will be continued at the expiration of our current policy, notwithstanding Alabama's continued clean record.

I might add that as a result of our cancellation, the Montgomery County School District premiums rose from $50,000 per year to

$118,000 per year while our total coverage decreased by over $300,000.

Second, premium increase—decreased coverage. A number of school districts have not had their policies canceled outright as was the case in Alabama. However, they have had to confront an increase in premiums coupled with a corresponding decrease in coverage. The decrease in coverage obtains in three ways:

(a) Premiums are raised and the deductible is increased. In 1984, the Stillwater School District in Oklahoma paid a premium of $1,568 for a $1 million aggregate policy which carried a $1,000 deductible. The insurance carrier dropped out of the market in 1985, and although the Stillwater schools were able to find a carrier to write a similar policy, the cost of the premium was nearly 14 times what it had been the previous year, while the deductible—the direct out of pocket liability to the school district—had doubled.

(b) Premiums are raised and the coverage is decreased. As an example, the Alexander Central School District in New York State paid $4,251 in 1984–85 for $10 million in coverage. In 1985–86 the same district paid over $17,000 for half the previous year's coverage.

(c) Premiums remand unchanged by the policy contains new exclusions of coverage. Many school districts have been delighted to learn that their premiums will not be raised only to later discover that their coverage was subject to a number of exclusions. This, athletic injuries, child sex abuse, legal liability for board members and officers, asbestos removal and pollution control are routinely being dropped from policies. Any financial liability in these areas must then be directly assumed by the local school district or the individual board member in their personal capacity.

As you know, local school districts operate on limited funds. The average school district receives less than 6 percent of its resources from the Federal Government, the remaining 95 percent comes from the tax dollars of our communities. School boards are in the business of education. Every dollar that is paid out in insurance premiums, litigation costs, or as a deductible toward damages, takes away from our districts moneys that are entrusted to local school boards by the taxpayers of their community to assure the education of the young people of this Nation.

Because school board members feel so strongly that the education of our young people must continue as a national priority, we have tightened our belts in every way we can think of to ensure that we can continue providing these children with an education which is worthy of them and an environment that is secure, despite our insurance worries.

School board members across the country are actively working with their state legislatures to come to grips with this crisis. The New York State School Boards Association, in recent testimony before the New York Assembly Insurance Committee, prevailed on New York's legislators to create a new category of insurance for local units of government which are currently treated the same as commercial entities when it comes to acquiring insurance in New York.

Furthermore, the New York Association of School Boards requested that legislation be adopted which would permit insurance

pooling; place a threshold cap for pain and suffering awards; allow structured awards or allowing the payment of awards to be made over a period of time; place a cap on attorney fee awards; and finally, legislation which would restructure the doctrine of joint and several liability which, in most States, permits a plaintiff who has proven that one or more defendants in his case is liable for at least some of the plaintiff's damages, to recover 100 percent of the money owed by all the liable defendants from any one culpable defendant.

In Illinois the Association of School Boards is actively seeking State legislative action in the area of tort reform, while the Oklahoma State School Boards Association is working hand in hand with their State legislature to address excessive awards under the State workmans compensation statute.

Those that I mentioned are merely examples of the attempt school board members across the country are making at the State level to bring the insurance crisis under control.

Although State law governs cases arising in tort, the Federal Congress has also taken action which has contributed to legal liability on the part of school districts where none existed before. In particular, this liability stems from section 1983 of title 42, providing for payment of unlimited costs and attorney fees to parties who prevail in civil rights cases. Presently, yet another attorneys fee statute is pending before the Congress—the Handicapped Children's Protection Act of 1985. If this legislation is signed into law, it will provide that school districts must pay the unlimited costs and attorney fees of parents who prevail at the administrative as well as the trial court level in Public Law 94-142. Just as the unpredictability of damage awards has been proffered as a basis for increased premiums, so too, have insurance carriers pointed to the unpredictability in attorney fee awards, as yet another reason to increase premium fees.

National School Boards Association has actively lobbied for a prohibition against the award of costs and attorneys fees at the administrative level, and for passage of legislation which caps the hourly rate of attorney fees at the trial court level, while eliminating the inclusion of multipliers and bonuses in any final fee award.

School board members are not experts in the field of insurance. It is not our intent to tell you, this committee, that the insurance industry should be restructured or that only Federal intervention will resolve the insurance problem facing local units of government.

Alternatively, we cannot stand idly by while the insurance industry restructures school districts across the Nation—however inadvertently that restructuring might be—because of the unavailability of affordable premiums in exchange for adequate coverage of the services and programs school boards are mandated by law to provide.

National School Boards Association thanks the Congress, and this committee in particular, for taking the time to familiarize yourself with this issue.

In closing, I would like to reiterate the fact that this is not a problem confined to one State or region. It is a national problem and a growing problem. If there is any way this committee can

work with us to resolve the severe, negative impact this crisis is having on local units of government and local school districts, National School Boards Association assures you that we are fully committed to working with you toward that goal.

Thank you.

Mr. FLORIO. Thank you very much.

On behalf of the subcommittee, let me express my appreciation to the three witnesses for their testimony today. I am struck by how things change in a relatively small period of time. The last time we were dealing with insurance issues was again at the bottom of the insurance cycle in the midseventies. You may recall, that we dealt with lots of medical problems, product liability problems. We passed some risk retention legislation designed to provide for more self-insurance, group insurance. We dealt with swine flu indemnification because liability insurance was not available for the vaccine manufacturers. And I am struck by the fact that if at that point Ralph Nader had come in and suggested, had even started to suggest some of the things that you have been suggesting and others have suggested routinely in the last few months, people would have sort of laughed and said that that was not realistic. Yet respected organizations, such as your own, are talking about some fairly dramatic, if not, some would say, radical changes in the structure within which we deal with insurance.

I am struck by the significance of some of the proposals that have been made today as well as by other organizations, with regard to changing the method of regulation at the State level. Proposals like regulation of commercial rates to insure that they are justified by loss experience, joint underwriting facilities, state owned reinsurance, prohibition of midterm cancellation, easier self-insurance for groups and systems for good risk management.

Pennsylvania is talking about a State operated liability insurance system for local governments. New York is advocating, apparently, banks and other financial services being able to go into the insurance business. I know Florida has a proposal for financial services institutions to go into the reinsurance business. So you just have got a very dramatic change in the whole spectrum of debate. I think that says much about where we have come from and I also think it says something about the gravity of the problem that we are facing, that these new types of proposals would be suggested by serious people and that the Congress would be asked to consider these types of things.

These are all directed to the State level. I would like to get your opinion as to whether you think that if any of these proposals are meritorious and they were implemented at the State level, whether it would be something that would be sufficient to be dealt with on a State by State basis.

I spoke before the American Institute of Architects last week, and they were lamenting the fact that in my State, the State of New Jersey, an executive order came down prohibiting midterm cancellations and the sole insurer for architects said that they were not going to insure in my State anymore. The concern, of course, is that someone would play off one State against another State.

If any of these proposals have merit, and were implemented at the State level, is there an argument that can be made that you

might see reason to support having Federal minimum standards for application of a principle such as this, that would constitute a floor so States could go beyond what would be advocated in the Federal standards system but would not be able to go below the Federal regulatory directives. Can I get anyone's thoughts on that?

Mr. FLAHERTY. I think I raised that principle directly in my written statement to the committee. Congressman, I think that a system, a Federal regulatory system, establishing a floor so that there is some consistency throughout the country would be very helpful. It is not just a possibility that insurance carriers play off one State against another, it is a fact. Moreover, the insurers are currently exempt from the antitrust laws. I think they take advantage of that loophole also.

They have told cities bluntly they don't want our business. I don't know if they have done that in order to try to get Federal support for the financing of insurance. I don't know what the reason is. A city of our size—90,000 people—only has one insurer make a bid on our insurance work even though we have had a very low experience ratio of claims to premiums paid. That is consistent not only in our State but also in other States and other types of governmental entities, I think there is a need, a crying need for a system of Federal consistency, whether that be a floor of minimum standards or some other type of system. But it is absolutely essential.

Mr. FLORIO. Let me ask the other two witnesses, because you both touched on the civil rights liabilities question. Let me address that particularly, but also the whole concept of liability awards. One of the proposals some of States are making is the question of commercial rates being regulated to assure that those rates are justified by loss experience.

Part of the problem that this committee is experiencing is the inability to get data on what losses are. For example, on civil rights matters, we have no data that has been presented to us to justify the concerns that you have expressed in anything other than anecdotal examples. The concern that some of us have is that if there is a need to modify the liability system, Federal tort reform, there may—well, we don't have the information designed to justify that. Over and above that, we are concerned that we are going to limit liability, we do not really want to limit liability per se, would like to limit injury so that liability does not result, that no one knows what they are talking about.

You mentioned the Jackson Township situation. I am very familiar with that. It is in my State and I am aware of it. That situation resulted in illegal dumping, the locality was informed about the dumping for long periods of time, made no effort to stop the dumping, and ultimately resulted in liability.

Some of us have been trying to emphasize the other side of the equation. Let's have some enforcement of regulation, let's have some enforcement of statutes, so as to reduce the potential for injury, which in turn will reduce the potential for judgments and liability, which should theoretically have some impact upon the stability of insurance prices.

The concern that some have raised is there is no relationship one to the other. Mr. Thomas, Director of EPA, testified and comment-

ed to me, that in the context of the Superfund discussions, when some from the insurance industry came in and were advocating fairly dramatic limits on liability under the Superfund cleanup activities, Mr. Thomas put the question to them as to whether if they got everything they wanted in terms of liability insurance limitations, they would be willing to write liability insurance.

The answer was no. So that if there is to be a correlation between limiting liability injury, and insurance rates, don't we need some mechanism for accumulating some hard data that we currently don't have? I ask for you to respond on the civil rights question that you are concerned about. Do you have access to information that would justify increasing insurance rates on the basis of some comprehensive study of the data in terms of losses due to civil rights actions?

Mr. RUSSELL. Let me try a little bit on that. I am not sure of the answer. In fact, I am very certain the answer is no, at this moment.

One thing, in terms of trying to get information, the National Association of Counties has undertaken an extensive study of the claims and losses in the civil rights area and we have recently agreed to join with that and poll all our members, and we will try to get the responses of those to you.

I would say, however, that there is not necessarily—certainly the insurance companies have told us that there is not necessarily a correlation between the actual losses and our ability to get insurance, because they go on the presumption or the predictability, the information of future losses, and claim that it is unpredictable, and therefore, either uninsurable or insurable at greatly increased rates.

I think we certainly have learned something from that crisis in terms of risk management, and I am sure that while that has taken less of a role in the past, it certainly will take a much increased role in local government in the future, just as I think certainly in front of the Connecticut Task Force on Insurance, the companies that indicated that they had taken a very light view of underwriting standards for municipal insurance in the past, that they would take a much harder look, much to our amazement, they still indicate to us that they have no figures, they don't keep municipalities separate from small businesses, they write them under the same general business policies. We can't get any information from the insurance companies on either premiums or losses divided by municipalities.

One of the other things that I think is important to look at is in the pollution area. The EPA came to our national seminar and indicated that they are indemnifying their contractors who do the cleanups under the exact same situations whether they be cleaning up themselves or whether they do not have a claim yet, but if EPA recognizes that there is a hazardous waste problem they will indemnify in order to get a contractor to in fact do the cleanup. They will indemnify them but that same thing logically doesn't carry over, in their minds, to us.

Mr. FLORIO. Let me, on that last point, I don't know of any authority for EPA to be indemnifying contractors at this point, so I will be happy to look into that, because I don't—the Superfund

clean up process, if that is happening, someone is really going to explain some things, because there is no authority at this point for anyone to do that.

My time has expired. Let me yield to the gentleman from Indiana.

Mr. SHARP. Mr. Chairman, I would like to yield to the gentleman from New Mexico.

Mr. RICHARDSON. I thank my colleague.

Mr. Chairman, I ask unanimous consent to revise and extend my remarks. Regretfully I can't stay. I might try to come back. But I would like to alert members of the subcommittee and members of the various industries and consumer groups involved, I am attempting to work on some legislation that I hope to introduce shortly on the entire product liability issue, the insurance issue, and I just wanted to make that point, that it is a very complicated and difficult subject, but I think it needs to be addressed.

I commend the chairman for holding these hearing. I regret I have to leave and I hope to come back.

Mr. SHARP. I yield back my time.

Mr. FLORIO. Mr. Ritter.

Mr. RITTER. Thank you, Mr. Chairman.

Mr. Flaherty, you talked about in your testimony some State actions taken in the area of tort reform that could serve as an example for action by the Federal Government. Could you explain that?

Mr. FLAHERTY. What I was referring to was joint and several liability, where a State or a city may be 1 percent or 2 percent liable for an accident.

For instance, in the example that is frequently given, a reckless driver goes through a stop sign which was partially obscured by a tree branch and the jury may find the municipality to be 2 percent responsibile. But under the theory of joint and several liability, the plaintiff can collect the entire judgment from either party, leaving the party that it collects from to try to get recompensed by the majority liable party. If that party is judgmentproof, then the deep pocket defendant suffers. I think that governmental entities are always seen as deep pockets and there clearly needs to be some reform at the State level regarding the joint and several liability doctrine.

Many States have limits on liability that are in my judgment very, very low. Cities and towns of Rhode Island are only liable for $50,000 in damages, so that if a plaintiff is severely injured, clearly injured through negligence of a city or town, a bill is introduced in the legislature to increase the liability limitation in the particular case to $5 million, as happened to Warwick in one case, and now our liability has suddenly exploded to $5 million. Perhaps if that limit were raised, it would be not as much of a temptation for the legislature to create exceptions to it. Those are the types of things I am referring to.

Mr. RITTER. So, you would like to see some guidelines or stand ards that would have the effect of law on superseding the responsibility of the States in this regard?

Mr. FLAHERTY. I am sorry, superseding the authority of the State?

Mr. RITTER. Yes.

Mr. FLAHERTY. I think the reforms should happen at the State level. In my judgment, tort reform is the primary responsibility of the States and should be done on a State-by-State basis. Tort reform is only one part of the problem that I think will essentially solve the crisis. Another part is risk management on the part of cities. While rates and losses were low in States and towns across the country, I would concede that there wasn't a great deal of attention paid to risk management by the insured parties. Now it has become a much more compelling type of thing because we can't get insurance.

The insurance carriers themselves are the only source for the data on the industry which the chairman mentioned. We can't get it from them. We can't get data from the insurance company to explain why our premium was increased tenfold. If you can get it from them, then you are better men than we are. We can't do it. I don't think the cities have any access to that type of information. There are several possible approaches to the crisis, including tort reform, risk management by cities, and reform of the insurance industry.

Mr. RITTER. Those are three distinct—any non-Federal recommendations?

Mr. FLAHERTY. I don't believe so. I don't think the 1983——

Mr. RITTER. Tort reform?

Mr. FLAHERTY. The tort reform by the States is not a Federal question. Risk management is a non-Federal question. The applicability of section 1983 of the Civil rights Act, however, is a Federal question. Also, the fact that insurance carriers are exempt from the antitrust laws is a Federal question. The fact that the number of insurers is kept artificially low, because there are Federal regulations prohibiting banks from getting involved in the insurance business, is a Federal question. So, there are a number of Federal questions that can be addressed.

I read a statistic this morning that insurance premiums for homeowners of various types is now the third leading expense of homeowners, being exceeded only by food and shelter. We see a trend where it has become a big part of life, not only for families, but also for the governmental entities. It cries out for Federal intervention.

Mr. RITTER. In regulating homeowners' insurance?

Mr. FLAHERTY. No.

Mr. RITTER. I am trying to pin this down. Where, for example, in the civil rights law are there actions being taken, tort actions being taken in Federal courts? Could you give us some concrete——

Mr. FLAHERTY. I can give you an example. I think it was mentioned that section 1983 is being used to appeal an action by a zoning board. A property owner will appeal the decision of the zoning board and throw in a count claiming a violation of the civil rights laws, thereby bringing it into Federal court. If there is a finding of a violation—and section 1983 has been greatly expanded—there have been more civil rights actions filed in the last 2 or 3 years maybe than in the rest of history combined—then other costs attach to the judgment, including the payment of attorney's fees.

Mr. RITTER. How is zoning used? How is this zoning law used along with the civil rights?

Mr. FLAHERTY. By making a claim that a judge views as having some merit—for example, the zoning board violated the petitioner's civil rights by failing to give him a fair hearing or due process. Once something gets into Federal court there is always a possibility it will be successful. We never get a claim in the police area now. That doesn't have a civil rights claim attached to it. The vast majority of those cases, when a local city or town policeman makes an arrest and a claim of false arrest is made, end up in the Federal court rather than State court, because the Civil Rights Act is used as a vehicle.

Mr. FLORIO. The gentleman from Minnesota.

Mr. SIKORSKI. I don't have any specific questions now I do have a lot of questions, but in the interest of the full agenda, and the other witnesses, I want to thank this panel for their written and oral testimony. It is very helpful, and I compliment the chairman for continuing our investigation and analysis of this important topic.

Mr. FLORIO. Mr. Lent.

Mr. LENT. Thank you, Mr. Chairman.

Mayor Flaherty, in your testimony you advocate minimum Federal standards for the regulation of insurance companies. One of the minimum requirements you propose regards excess profits. You propose that States be required to establish plans for the return of so-called excess underwriting profits.

My question is: What provision will you make for recovering excess profits when courts open up antique policies to respond to today's claims? In other words, claims filed today against antique policies or policies that were written years ago. Suppose the company had kicked back to the State the excess profit, and then the claim arises, 10, 15 years after that policy was issued, which is what is happening in the case of many of these long tail situations.

Mr. FLAHERTY. I believe what you are referring to, Congressman, is the difference between the claims made and the occurrence type of policies. Under the occurrence policies that we are accustomed to, if a person were insured at the time the act occurred, he or she is considered covered even if the claim is not made until 5 or 10 years after the insurance policy has expired.

Mr. LENT. Let's suppose in that early year you had given back to whatever the State or whoever is going to take these excess profits back, and then 5 years down the road a claim is made against that policy. How would you handle that sort of situation?

Mr. FLAHERTY. I am not proposing that excess profits over certain amounts be given back dollar for dollar, either to the State or to the policyholders. I do feel, however, that some of the excess profits should be retained. Something would have factored into the occurrence type of policies.

Mr. LENT. Let's move on. You have another concern; that the present antitrust exemption is the cause of some of the problems that municipalities are finding vis-a-vis their insurance coverage. Yet you don't seem to cite any situations where the antitrust exemption has resulted in increased premiums. Do you believe that any of the present problems stem from activities by the insurance industry that would be subject to antitrust regulation? If so, can you give us one or two examples?

Mr. FLAHERTY. If you are looking for a specific case in Rhode Island or Iowa or anywhere else, I cannot provide you with an example. It is difficult for me to believe that all of the companies have increased their rates the same amount at the same time, while claiming that the increase is due to gradual trends in several different areas. The explosion in rates was not gradual; rather it was sudden by all the companies at the same time. That makes me suspect that the insurance companies have at least had casual conversations with regard——

Mr. LENT. All these companies? All these companies are subject to the same types of risk, corporate decisions, expanded liability, and State regulations, so it would seem to me that it is not unusual that there would be a certain amount of concert that would accompany either the lowering or the increase of rates. We know that insurance rates went down during the high interest period.

Mr. FLAHERTY. That is right, but what is unusual to me is that it happened overnight. If one asked the insurance industry to explain the explosion in rates, they will give a scenario that begins 10 years ago. I am not trying to paint them as entirely responsible. I am not trying to say that the insurance companies are the sole cause. However, the effect on cities has been overnight.

Mr. LENT. So, it is really just a question of surmise on your part that elimination of antitrust would somehow attack the root cause of the problems we are discussing today?

Mr. FLAHERTY. I think it would. Moreover, the purpose of the antitrust laws is to foster competition. There isn't any competition out there right now. We can't get bids. There are hundreds of insurance companies, probably a dozen or so licensed to do business in the State of Rhode Island. Yet only one of them bid to cover Warwick. The insurance companies will tell city officials bluntly, if asked, that they don't want your business.

Mr. LENT. Well, presently there are complaints that there was a time 4 or 5 or 6 years ago when there was too much competition, that the insurance companies were undercutting one another in an effort to get the premium dollars so they could slap it into interest bearing accounts and take advantage of those high interest rates. So, there was a period when insurance was priced very low, and we all enjoyed that period, and now things have changed around a little bit. The interest rates have come down and we see that there is less desire on the part of the insurance companies to participate in these markets.

Mr. FLAHERTY. The insurance industry is so important not only to the individual elected officials who are subject to personal liability, but also to the taxpayer in any given city or town or school district. Because it is such a big part of commerce and the American social and economic system and is also subject to wild cyclical swings, it should be regulated and regulated in a different way than 50 sets of separate regulations which have been played off one against the other in the various States. That is the situation we face now.

Mr. FLORIO. Time has expired.

Mr. Fields.

Mr. FIELDS. Thank you, Mr. Chairman.

Mr. Flaherty, on page 19 of your testimony, you talk about minimum Federal requirements supplemented by additional State requirements, and you do a good job of elaborating the minimum Federal standards, but—perhaps I missed it—what are some of those additional State requirements that you alluded to?

Also, let me add a compatible question. What is your State doing in regard to those State requirements?

Mr. FLAHERTY. Some of the state requirements that I had in mind include the tort law reform we could use in our State, and I am sure are applicable in other States. We budgeted twice as much in our 1985 budget as we had in our 1984 budget, for insurance. We knew that we were going to be hit with an increase. What we did not expect and what sent us reeling and sent other cities and towns reeling are increases of 800 or 1,000, or 2,000 percent against law loss experiences which did not suggest that we would get hit like that.

I think in our State, we are starting to respond. The legislature is looking at it, the League of Cities and Towns in the State of Rhode Island has formed a subcommittee to look into the possibility of pooling, either by pooling to buy one policy or establishing a self-insurance fund. In fact, we are meeting with the consultant next week, who has set up a pool in Connecticut and in Texas.

We have asked the Governor and the Governor has agreed to set up a task force to look into the problem of insurance. It isn't just cities; it is doctors, day care centers, small businesses, and other providers of essential services. So, we are responding. Unfortunately, we were taken by surprise by the extent of the problem. We didn't know it until we failed to review bids. How would we know it until we sent out the bid? Thus, our response has been in reaction to the problem, not in anticipation, of it.

Mr. FIELDS. Mr. Russell, in your State of Connecticut, what are you doing on this issue?

Mr. RUSSELL. We have 40 pages of recommendations to the Governor and ultimately to the legislature and I will be happy to give you a copy of the report, which was just completed this past week.

Basically, in addition to some of the things that have been mentioned so far, we are talking about things a number of recommendations that relate to getting us information, early warning of cancellations, and nonrenewals, some limitations, although not exclusive limitations on cancellations, that there would be some areas in which it would be possible still to cancel a policy, most notably for loss of reinsurance.

A number of things that we are recommending to, and the task force was made up of not only local officials but insurance association people, trial lawyers. So, a number of them went toward municipalities themselves in terms of risk management.

The State legislation that will be necessary to allow us to set up meaningful risk pools in the liability area are some of the other recommendations, and there are a whole host of other things—collateral source reform—so people know that there are other remedies and other awards have been given in the same case.

Mr. FIELDS. Did I understand you to say you are a school board member?

Ms. WEIL. Right.

Mr. FIELDS. My dad has been for 19 years in Humble, TX. I will have to say your job is much more difficult than mine.

Ms. WEIL. Thank you very much.

Mr. FIELDS. I, certainly, applaud you being here today and I was going to ask you to elaborate on the paragraph on page 8 where you talk about how Congress has taken action, and is planning to take action, that actually increases your liabilities as a school board member, and your school district in general, and ask you to elaborate on that paragraph, if you could.

Ms. WEIL. Actually, the Handicapped Children's Protection Act is creating an additional avenue at the Federal level for additional recovery and the recovery of damages are going far beyond the educational programs and the relief of education young children. Of course, we think if parents are interested in education that at the time we alleviate that problem, then we should have satisfied. Unfortunately, through the Federal courts and the attorneys fees, particularly now at the administrative level, the court in *Smith* v. *Robinson* were in our favor, that there would be no attorneys fees levied at the administrative level.

However, the bill pending in Congress now would allow the collection of those attorneys fees at the administrative level where relief can be received through the efforts of the parents and the school district without even their being an attorney at that point. Now, we don't read them going further than that if necessary, but at least at that level, there can be some relief without going into additional damages. So, that has increased tremendously the burden on us so far of the payment of these things.

The one thing that also I harken back to data all of us need in order to increase this dialog. We are unable to get that information. National School Boards Association tried last year to survey the issue in 1985 and has found that through insurance commissioners of the State level that information is simply not available and you here raising of awareness, and that is one thing that probably would be a noncontroversial area, is to set up a mechanism whereby that information could be gleaned so that we know what we are talking about besides my own personal example of insurance cancellation with no early warning, and then the increased ability of the Federal level to put us into Federal court further and collect fees higher up than normal.

Mr. FIELDS. I know my time has expired but I would ask if Ms. Weil, through her association has specific examples in this area. I know I would have an interest and I think the chairman has an interest for effecting a good record. If the record would be open for those specific examples.

Mr. FLORIO. All of the witnesses today would certainly be authorized to submit supplemental materials that they may have to flesh out their testimony.

Ms. WEIL. We will be glad to do that. Thank you.

Mr. FLORIO. Time has expired.

The gentleman from Indiana.

Mr. COATS. No questions.

Mr. FLORIO. On your last point, ma'am, when you say it would be relatively noncontroversial that we get to the point of knowing what it is you are talking about, I would suggest to you that heart

of the controversy, that somebody knows what it is they are talking about and the flow of information and who has authority to make those decisions, is really almost the heart of the controversy.

Let me just conclude with just one last observation, or question perhaps, to the mayor, since he raised the point about risk management at the local level or State level, or whatever.

I think we all know that is not without controversy itself. Would you be offended, would any of the panelists be offended, if your local insurance company comes in and says that we will provide you insurance but you have got to do the following things for us to provide you with insurance, or if you don't, you will pay higher amounts rather than lower.

If you have a municipal landfill, EPA doesn't have too much interest in spelling out safe and appropriate regulations, therefore, we, the insurance people are going to tell you what we are going to require of you in order to insure. Assuming these things are reasonable, are you in any way concerned about that being perceived as a delegation of governmental power to a private sector entity and would this be something that you would feel perhaps be in position to supplement your risk management capability?

Mr. FLAHERTY. Is that to me?

Mr. FLORIO. Anyone.

Mr. FLAHERTY. I don't have a problem with that. I want to reduce risk. It isn't that we want to win lawsuits or have somebody else pick up the tab. We don't want to be involved, we don't want people hurt, we don't want landfills to be dangerous. We welcome the expertise that the insurance industry could provide in pointing us to areas where risk could be reduced. We do the best we can and we certainly have an awareness of the benefits of risk management. I think all governmental entities do.

But the problem that we have now is that the rug has been pulled out on us, and as the woman from Alabama said, it is a necessity at any cost in many cases. If the insurance industry can point out areas of risk management which would benefit mutually I certainly would welcome that.

Mr. FLORIO. That is not, as you can appreciate, a particularly radical approach in the area of fire insurance. The industry has for a long period spelled out what is appropriate. When those proposals are suggested, some describe them as naive, saying that the insurance industry has no particular interest in being a policeman, in playing some sort of public sector role in spelling out what should be mechanisms designed to minimize risks, and therefore, since they have no particular interest, it is not in their final interest to do that, they are not anticipated to play any role.

The counterresponse to that, some have suggested may be the case now, when there is no particular competition outside of the industry, expressing interest in being in the industry, but when you people, such as yourselves, suggesting final services, whether they be at State level or the Federal, that are not in the insurance industry, be given leave to go into the industry and that some other types of financial service institutions would be willing to come in to provide insurance, with guidance as to how to manage risk, then you might get the insurance industry to be more inclined to play that more aggressive role than they are currently inclined to play.

So I think these are interesting times for all, including the insurance industry, as we are in a State of flux and it may be, as I said before, the testimony today was radically different than the testimony 10 years ago, when we had our last bottoming out of the cycle, and it may be when we come here 10 years from now—assuming any of us are here 10 years from now—that much of what we are talking about, in a way dancing around the edges, as to who is going to be in the insurance business, will be as acceptable as some of the things that you have suggested that were not acceptable 10 years ago.

Mr. Lent.

Mr. LENT. I want to ask one question of Mr. Russell, who described this Jackson Township pollution judgment and indicated that the companies insuring Jackson Township were forced to pay, I think, $15.8 million. That judgment was later reduced to $5.8 million, despite the fact that the insurance policy had a $1 million policy limit, is that correct?

Mr. RUSSELL. Yes.

Mr. LENT How is that possible?

Mr. RUSSELL. Well, I think there was perhaps a law made by the courts in that case. It was I believe a determination that of how many instances of pollution there were, whether it was everytime somebody took a drink of water was one instance, or whether the pollution was one instance. It was determined by the court, I believe, that each time the person took a drink of water then there was further than that, it was extended to include not only people who had been injured by that but people who might potentially be injured in the future. That was the bulk of the award as well. It was determined that the insurance covered that on an individual occurrence basis.

Mr. LENT. So, given that sort of a court interpretation of the cap on the policy of insurance, isn't it somewhat reasonable to expect the insurance industries are going to raise their premiums in anticipation of that sort of decision being carried over across the country to other similar situations?

Mr. RUSSELL. Well, frankly, my personal opinion is not only is it reasonable for them to raise their rates, it is reasonable for, under that scenario, to do exactly what they have done. That is, to refuse to write insurance. On that issue they have no idea, and the cost potential is so high. That is why we have to have some kind of relief from that situation. I don't blame them for not writing insurance in that area.

Mr. FLORIO. Just to clarify, Mr. Russell describes the case in a little more fluid way than it really was decided by the court, but I think the thing that is most significant is the court applied the very conservative, traditional approach to interpreting insurance contracts, that when there is ambiguity in the contract, it should be resolved against the insurance company, and that in this instance, hopefully learning from this, that those questions, those specific questions, that flow from insurance language are going to be written in a more objectively verifiable way before the policy is undertaken.

But I appreciate the point the gentleman is making and certainly the hope is that insurance companies can evaluate risk. After

all, that is what insurance is all about, attempting to evaluate risk. What we should all be trying to do is minimize the parameters within which that risk determination can realistically be applied.

I have made reference in a previous hearing, to lines of insurance that the industry has become involved with in insuring the possibility of foreign governmental coups, for multinational corporations' liability coverage overseas. It is interesting to note, I have had brought to my attention, the insurance industry is becoming involved in financial insurance in areas that smack of commodity futures. Insuring against the changes in the value of the dollar, insurance against evaluation changes.

I am confident that the insurance industry can rise to the level of evaluations of risk so when we get out of having these peaks and valleys in the insurance cycle to agree that we can minimize the peaks and valleys, the traditional business of underwriting risk analysis will be something that the insurance industry will continue to be able to do.

I thank the gentleman.

Mr. LENT. I wonder if the witnesses would agree with the chairman's characterization of the decision in the *Jackson Township* case as carrying out traditional, conservative interpretation of insurance policies? My understanding is that where there is an ambiguity in a personal insurance policy, there is a line of cases which would hold that ambiguity to be resolved in favor of the insured. However, in commercial insurance, which is of the sort that was written here, in the *Jackson Township* case, the contract stands as a contract and is interpreted purely as such, without the special rule?

Can you explain that?

Mr. RUSSELL. If I may, I am getting legend in Connecticut for this, but not being an insurance person and not being a lawyer, I can't be disbarred or eliminated from the industry. My interpretation would have been that it was not traditional, that it was a startling new concept that came out of the *Jackson Township* situation.

Mr. LENT. It has been written up in law reviews and in the legal journals as such, has it not?

Mr. RUSSELL. I have read about it and it is getting so much further that even them, I think it is being considered the landmark case in the situation.

Mr. LENT. Thank you.

Might the Congress address that issue before it starts getting into excess profit taxes and so forth?

Mr. RUSSELL. Well, I think in my testimony, I indicated that we just have to deal with the pollution insurance issue. As I think I answered the chairman's question before, I don't blame the companies for not writing pollution insurance under the interpretation given in this case. I think we have to respond to it.

Mr. RITTER. I would like to just add a point to this discussion. You talk about better risk management, which means that one has to better assess the risk, and there is a fledgling science of risk assessment to define what precise risks might be.

The problem is, there is a widely divergent view in the society as to what levels of risk are acceptable. There are those who firmly believe that zero risk due to some corporate imposed risk, is the

target. We know that is impossible, yet that is being carried into the courts or a tendency to seek zero risk is being carried into the courts. The assessment of risk in the pollution cas^ I am sure is a very interesting example. I would like to see precisely how the risk was attributed to individuals and what levels of human health danger were incurred by this pollution exposure, this pollution experience, but I can tell you that there is no agreement on what this exposure means and not only scientifically, but politically, and ideologically. We can assess risk technically but interpretation of this impact on human health of the environment varies widely and gives a real moving target to the insurance companies or any financial institution, whether it is a bank or something else that is not in the business today, who might want to be involved in this.

I would like to add, Mr. Chairman, that the Insurance Services Office, Inc., which gathers data for the insurance industry, has generated data on loss ratios for 1980, 1981, 1982, and 1983, and in each of those years, I can just quote those loss ratios, in 1980, 1.658, 1.510 in 1982, 1.88 in 1983, to .097. I have a feeling intuitively in 1984 and 1985 the ratios might even be greater. So we are talking about for the year 1983, for example, earned premiums of approximately $60 million and incurred losses of approximately $125 million, and these are for all States combined, and the category characterized as municipal classes of insurance. I would like to enter that exhibit.

Mr. FLORIO. If the gentleman will yield on that point, because he highlights a very significant point, those are overall numbers, they are not universally agreed to by all. Assuming they are the case, I think the point some have raised is that in specific lines there either is no information available to deal with justifying increases of costs in those lines or the information that may be available is the very opposite of the conclusion, that we had testimony from day care center operators and from a number of others—nurse/midwives—that in fact the loss ratio did not justify increases, much less the increases that people have.

So I think the need for data is something that is absolutely essential if we are going to have some rational decisionmaking taking place at whatever level that it is required to take place.

Mr. RITTER. I agree. What I am simply saying, there is some data out here that might be relevant in addition to the municipal classes. There are various black downs, for example, governmental subdivisions, in terms of loss ratios; there is public schools. I might add that in 1983, the earned premiums in public schools were approximately $24 million. The incurred losses were $51 million, and also in the categories streets and roads, which is interesting, the earned premiums in 1983 were $6.5 million for this particular survey and the incurred losses were $33 million. I would ask unanimous consent, Mr. Chairman, that these additional tables be placed in the record

Mr. FLORIO. Without objection.

[The tables referred to follow:]

INSURANCE SERVICES OFFICE, INC.
160 WATER STREET NEW YORK N Y 10038 (212) 487 5000

STATISTICAL DATA FOR SELECTED CLASSES

Municipalities The attached data labelled "Governmental Subdivisions" (Exhibit III Sheet 2) includes CSP liability statistics for boroughs, cities, towns, townships, villages, counties and parishes reported under governmental subdivisions classes, as follows:

Code	Class
	Municipalities
91250	. population under 2,500
91251	. population 2,501 - 10,000
91252	. population 10,001 - 25,000
91253	. population 25,001 - 50,000
91254	. population 50,001 - 100,000
91255	. population 100,001 - 250,000
91256	. population over 250,000
	Counties
91257	. population under 10,000
91258	. population 10,001 - 25,000
91259	. population 25,001 - 50,000
91260	. population 50,001 - 100,000
91261	. population 100,001 - 250,000
91262	. population over 250,000

The data excludes some municipal exposures which are separately classified and rated (for example, stadiums, zoos, hospitals). Since many of these operations are similar or identical in exposure to enterprises in the private sector, separate statistics are not maintained in all cases for private vs. public classes of this nature. An exception is schools, where there are separate classes for public (presumed municipal) elementary, kindergarten, junior high schools, high schools and junior colleges. This data is provided as "Public Schools" (CSP Classes 82113 & 93221) in Exhibit III Sheet 3. The classification "Streets, Roads or Highways" (CSP Classes 92151 & 93151) is considered to be primarily municipal, although federal, state or private exposures are possibly in this class as well. The data for this class are provided in Exhibit III Sheet 4.

Exhibit III Sheet 1 labelled "Municipal Classes" is the sum of the three previously described exhibits: "Governmental Subdivisions," "Public Schools," and "Streets, Roads and Highways."

The experience for these classes was quite unfavorable in 1980 and has deteriorated since then. As of 1983, insurers were paying out $2 in losses and expenses for every $1 of premium.

GENERAL LIABILITY INSURANCE

Monoline & Package Business

All States Combined

Municipal Classes *

Policy Year Ending	Total Limits Earned Premiums	Total Limits Incurred Losses **	Claims	Loss & Loss Adjustment Expense Ratio
12/31/80	17,550,761	29,097,232	3,073	1.658
12/31/81	36,486,980	55,455,837	5,124	1.520
12/31/82	50,807,140	80,688,366	7,150	1.588
12/31/83	59,395,665	124,566,415	10,164	2.097

* CSP Class Codes 91250 - 91262, 82311, 93221, 92151, 93151

** Losses are developed to ultimate settlement level and include all loss adjustment expenses.

INSURANCE SERVICES OFFICE, INC.

Exhibit III
Sheet 2

GENERAL LIABILITY INSURANCE

Monoline & Package Business

All States Combined

Governmental Subdivisions *

Policy Year Ending	Total Limits Earned Premiums	Total Limits Incurred Losses **	Claims	Loss & Loss Adjustment Expense Ratio
12/31/81	13,966,938	13,694,753	910	0.981
12/31/82	26,561,019	28,305,605	2,283	1.066
12/31/83	29,056,185	40,458,972	3,222	1.392

* CSP Class Codes 91250 - 91262

** Losses are developed to ultimate settlement level and include all loss adjustment expenses.

GENERAL LIABILITY INSURANCE

Monoline & Package Business

All States Combined

Public Schools *

Policy Year Ending	Total Limits Earned Premiums	Total Limits Incurred Losses **	Claims	Loss & Loss Adjustment Expense Ratio
12/31/80	10,899,798	14,065,836	1,748	1.290
12/31/81	15,233,173	20,370,420	2,527	1.337
12/31/82	17,046,915	25,371,053	3,005	1.488
12/31/83	23,776,833	51,344,138	4,919	2.159

* CSP Class Codes 82113 and 93221

** Losses are developed to ultimate settlement level and include all loss adjustment expenses.

GENERAL LIABILITY INSURANCE

Monoline & Package Business

All States Combined

Streets & Roads *

Policy Year Ending	Total Limits Earned Premiums	Total Limits Incurred Losses **	Claims	Loss & Loss Adjustment Expense Ratio
12/31/80	6,650,963	15,031,395	1,325	2.260
12/31/81	7,286,869	21,390,664	1,687	2.936
12/31/82	7,199,206	27,008,708	1,862	3.752
12/31/83	6,562,647	32,763,305	2,023	4.992

* CSP Class Codes 92151 and 93151

** losses are developed to ultimate settlement level and include all loss adjustment expenses.

Mr. FLAHERTY. Taking what you said into consideration, Congressman, what you are describing is premiums versus losses. In those years to which you are referring, there were additional moneys earned by the insurance carriers. Again, I am not trying to describe that as the only problem. However, it doesn't take into account the moneys that the insurance companies earned on investments from those premiums. I think that it is common knowledge in those years that the premiums were set intentionally below what they should have been in order to get the business to have investment funds.

Mr. LENT. If the mayor's excess profit recapture tax was put into place, and the excess profits on the investments of insurance companies had been taxed by the Government, insurance companies would not have been able to use those investment profits to offset the losses that were in excess of the premium actually collected.

Mr. RITTER. If you would yield back, in 1983 is really outside the realm of the very high interest rates. So when you take a loss ratio, for example public schools, of greater than 2 to 1; for streets and roads of approximately 5 to 1; you would, for example, have to earn on that streets and roads premium, you would have to earn 500 percent on your investment in order to cover that kind of a loss ratio. So I think, within limits, I think your point is well taken. These data do not include those figures, but on the other hand, when the loss ratios get up there, you are talking about massive imbalance in payout versus premium.

Mr. FLAHERTY. If I could respond to your question. I didn't say tax. There are other ways it can be done. Excess profits can be held as additional reserves. What you are saying is what I am saying. I might not have kept the low rates that we were used to in the 1970's and early 1980's but it would have leveled things out to eliminate the cyclical swings. That is the point I was trying to make as to why some regulation, a floor set at the Federal level, might be necessary.

Mr. LENT. Except that we all agree that when the investment profits were high, the premiums came down. Presumably the fire district, school district, cities and towns obtained very cheap insurance in the face of all of that competition that was out there in the marketplace for their premium dollars, so that those premium dollars could be put into investment.

If we had some sort of an investment excess profit mechanism, presumably the marketplace would not have been permitted to operate and we would not have had the advantage of those low premium years which we now look back on with a certain amount of nostalgia, because the investment profits are not there anymore, the interest rates are down, Reagan's economic recovery program is working, and therefore, we have to charge more for the insurance.

Mr. RITTER. I think to oversimplify the good times versus the bad times, as a function of the state of the economy and interest rates, I think we would be missing the point. There are major structural changes going on in our Federal laws, in the tort law—I think you yourself recognize that—that go well beyond just the balancing off of two economic periods.

For example, for the first time today, for the first time, long latency disease claims are being paid by insurance companies in situations that go back to the early forties. This is new on the horizon, the kind of things that Nellie Weil was talking about are really new players in the game. I think if we don't recognize that, we are not going to be able to get the kind of information we need to solve the problem.

Mr. FLORIO. Time has expired.

Let me express my appreciation to the panel for its participation this morning. It has been extremely helpful. We look forward to working with you.

In the interest of the schedule of our witnesses, we are going to call our next four witnesses together as a panel.

I would like Mr. William Bailey, chairman of the Governmental Affairs Committee of the Independent Insurance Agents of America; Mr. William Rue, chairman of the Government Affairs Committee of the National Association of Professional Insurance Agents of America; Mr. John Satagaj, president of the Small Business Legislative Council; and Frances Shaine, chairman of the Council of Small Business, Chamber of Commerce of the United States.

Statements will be placed in the record in their entirety, and we would ask that the witnesses summarize their statements. Mr. Bailey, we will be pleased to hear from you.

STATEMENTS OF A. WILLIAM BAILEY, JR., CHAIRMAN, GOVERNMENT AFFAIRS COMMITTEE, INDEPENDENT INSURANCE AGENTS OF AMERICA; WILLIAM M. RUE, CHAIRMAN, GOVERNMENT AFFAIRS COMMITTEE, NATIONAL ASSOCIATION OF PROFESSIONAL INSURANCE AGENTS; JOHN S. SATAGAJ, PRESIDENT, SMALL BUSINESS LEGISLATIVE COUNCIL; AND FRANCES SHAINE, ON BEHALF OF CHAMBER OF COMMERCE OF THE UNITED STATES

Mr. BAILEY. Thank you, Mr. Chairman. I am A. William Bailey, Jr., president of Bailey Insurance in Waco, TX. I am also chairman of the Independent Insurance Agents of America Government Affairs Committee. As an insurance agent, I represent both insurance companies and the consumer, a position which permits a broader perspective on this and other issues otherwise common to the insurance industry.

In the brief time allotted, I would like to outline a number of contributing factors to the availability/affordability crisis, and suggest some possible remedies.

There is no getting around the fundamental importance of the tort issue. Whatever else may have contributed to the current crisis, and whatever else may be done to seek improvements in insurance markets, the long-term insurability of risks rendered uninsurable by the courts and law will only be restored by changes in the tort system.

Such changes need be neither dramatic nor harmful to our fundamental interest in sustaining a civil justice system both accessible and fair. But a national reevaluation and reform of the concepts of fault, compensation, and evidentiary standards, to name

just three, is reasonable, and could go a long way toward restoring the predictability, and therefore the insurability, of certain risks. Two more points about tort reform: (1) tort reform is a necessary but not sufficient response to the insurance availability and affordability crisis, (2) it is not only an insurance issue. The country's tort system needs reform quite apart from the direct effect such changes might have on insurance markets.

The big missing link in today's insurance markets is reinsurance: the insurance insurance companies carry to permit coverage of large risks. The absence of this reinsurance capacity contributes to reduced overall availability and lower limits of coverage. Reinsurers' confidence has been shaken—or so they tell us—by the unpredictability of contract interpretation. And a return to American markets by reinsurers—again, we are advised from across the Atlantic—will be facilitated through use of a new "claims-made" contract which attempts to limit exposure strictly to the term of the policy. Finally, reinsurance costs, since they are largely uncontrollable, are a big factor in the affordability of insurance now available.

Having acknowledged the effects of tort trends and reinsurance on today's markets, the insurance industry must be clear-eyed and candid about its own contribution to the current crisis. By this I mean what one insurance company commentator characterized as "a price cutting binge" when double-digit interest income could offset underwriting losses totally unjustified by loss and expense experience and totally at odds with the need for reserve and surplus strengthening.

"The industry," this usually candid insurance company representative continued, "has paid a terrible price for the folly of 'cashflow underwriting.' It has weakened its public credibility and sapped both its financial strength and that of the reinsurers of whose inexperience and naivete it was so willing to take advantage."

Another largely controllable reaction to the real availability crisis in lines of insurance such as environmental liability, has been to treat less obviously troubled risks with the same defensive mentality. To be sure, steps must be taken to shore up reserves and protect against future, unsustainable losses where the courts and laws have conspired to render risks uninsurable.

But not all risks have been similarly undermined, nor all underwriting made as unfathomable as the celebrated examples of pollution and professional liability. As my national association's president, Mr. Richard Taylor, recently remarked: "Underwriting is the science of trying to find a way of writing a risk—not trying to find a way to get out of writing it. It seems now the underwriters are trying in most cases to find a way to get out of writing a new piece of business."

No amount of changes in the tort system or in reinsurance availability will prevent the persistent recurrence of today's crisis if not accompanied by industry reform of pricing and underwriting policies.

More than most industries, insurance, because of long-term exposure, reserving against future loss, and claims losses—is affected by swings in the general economy. As the criticism of insurance com-

pany pricing practices in a high interest rate economy imply, the dramatic drop in interest rates over the past few years has taken its toll on insurance company profitability and surplus. All the more reason for the industry to avoid exaggerating this natural vulnerability by ill-conceived pricing and underwriting decisions.

Statistical arguments are always slippery, but insurance industry statistics show an industrywide net operating loss last year for the first time ever—and we believe them. Others' statistics reach different conclusions, and beyond a rudimentary level of understanding quickly reached by those of us unschooled in the actuarial sciences, it is frankly difficult to know what ultimately will come of this furious debate.

As an insurance agent, I know what I see in the market, and I see many of my companies hurting financially, in part from the self-inflicted wounds of price cutting a few years back, but in part too from economic circumstances beyond their control. Until an objective, knowledgeable statistician can be called in to sort out all the numbers, the existing statistical evidence should signal caution in drawing firm conclusions or pursuing policy decisions which could further weaken an already financially strapped industry.

Although highly regulated, the insurance industry is a member in good standing of the competitive, relatively free market. From this fact, a couple of general points should be made: First, short of turning the insurance industry into a public utility of mandated, take-all-comers coverage, it is simply an economic fact of life that not all risks will be insurable at all times, or at low prices, and second, criticism of, and proposed solutions to, insurance industry cash-flow underwriting bump up against this free market fact: The decision to offset underwriting losses with high investment income was also a decision to pass along to the consumer the benefits, in lower prices, made possible by that market. What would public reaction have been if at the time of record interest rate investment income the insurance industry had not competitively lowered the price of its product? These are the quirks and complexities of the competitive marketplace which must be taken into account.

With that outline of the multiple causes of the availability/affordability crisis, what can be done to help improve the current market?

At the Federal level, very little. Where the Federal Government has offered insurance directly, flood, crime, riot, crop, the results have been costly and inefficient. Where it has mandated liability limits or created new exposures, trucking, pollution liability, the results have been to intensify market distortions. And where it has attempted, thus far unsuccessfully, to impose national standards of coverage, health and auto no-fault, the prospect of raising to a universal level the potential high costs and market dislocations which might otherwise be limited by State experimentation has been enough to dissuade past Congresses.

There are two areas, however, which may require or benefit from a Federal approach. The first is Federal product liability tort reform, probably necessary to account for the flow of products in interstate commerce. The second is amendments to the Federal Superfund law CERCLA, to facilitate the restoration of now unavailable pollution coverages by eliminating retroactive liability for

risks never contemplated in pre-CERCLA insurance contracts, and by modifying the joint and several liability now imposed under CERCLA.

In the States, two avenues, should be pursued. First, state-by-state tort reform to address in a modest but effective way the tort issues which may he the greatest long-term effects on insurance markets: Costs of litigation, apportionment of fault, punitive damages, and others which may fit into individual state law contexts.

Second, State regulators now have the authority to ensure that insurance rates are neither inadequate, too low, excessive, to high, or unfairly discriminatory. That existing authority should be supported and used. Specifically, IIAA recommends and supports regulation for company solvency, including disclosure of financial data and the strengthening and protection of State guaranty funds. We also support regulations requiring advance notice of mid-term cancellation, nonrenewal, and premium increases.

Finally, in the market, we encourage, and are establishing through many of our State associations, voluntary, market assistance plans to help hard-to-place risks find coverage. Also in the market, although not universally endorsed by our state associations, and still an unknown quantity in terms of marketability and restoration of reinsurer participation in American markets, the new, industry claims-made form may help provide coverage where there is none now, and should be given a chance to work.

Mr. Chairman, as you yourself recently observed, insurance availability is complex, and has no simple causes or cures. Insurance agents stand ready to help you and other Members of Congress better understand this issue, and pursue short and long-term remedies which reflect the public's interest in having a competitive, financially sound insurance industry. Thank you, Mr. Chairman.

Mr. FLORIO. Thank you for your comprehensive statement.

Mr. Rue.

STATEMENT OF WILLIAM RUE

Mr. RUE. Mr. Chairman and members of the Subcommittee on Commerce, Transportation and Tourism of the House Committee on Energy and Commerce, I am William M. Rue, president of Rue Insurance located in Trenton, NJ. I serve as chairman of the Government Affairs Committee for the National Association of Professional Insurance Agents [PIA], of which I am a member and on whose behalf I speak.

PIA has more than 40,000 members. They are independent insurance agents and brokers located throughout the 50 States, Puerto Rico, Virgin Islands, and Guam. PIA members service all lines of insurance, but have particular expertise in the property/casualty side of the business. As independent business owners, we represent several insurance companies; we have access to a greater number of insuring markets through brokerage agreements and oversee an average staff size of five employees.

As independent agents, we have a legally recognized right to the renewals of the business we produce. This value exists between the agent and the company. Our clients are always free to choose their

company and agent at any point. The worth of our agency as a business is based primarily upon the assessed value of our renewal book of business. Therefore, while we may be a licensed agent for this company or that, our allegiance to our client is very strong. Company/agent relations may come and go, but we take great care to continually build and service our clientele, our business worth.

This unique characteristic of the American Agency System, as it is called, gives independent agents and brokers a unique perspective. We listen to and understand the concerns and needs of our clients. We then share these real-world realities with our companies so that sensible responses can be shaped. Conversely, it is our responsibility to take complex and highly technical insurance matters and make them clear and understandable to our customers. This translation responsibility has been placed to the supreme test during the current market conditions.

PIA appreciates this opportunity to share with the subcommittee our view of the current state of the marketplace, how we got there, what is being done, and what should be done about it.

The insurance companies and their rating organizations will provide great detail on how the insurance market arrived at this point. However, we believe an abbreviated version from our view might be helpful in placing all the economic and technical jargon into perspective. To do so, we will describe the three basic insurance markets and how they interrelate.

This is the first layer market, the market that provides the majority of insurance for most commercial coverage needs. Businesses seek to find coverage in this market first. It consists mostly of U S. domestic companies that are licensed and admitted to do business in one or more States. This market accepts the major bulk of insurance coverage for most of the commercial accounts. With some exceptions here and there and with variations to some degree, the kinds of risks insured, the coverages offered and the limits of liability secured are generally of a standard nature.

This is the first level of specialty market. Clients that need more coverage than the primary market will offer or which require specialized coverages for the unique nature of the risk being insured, seek a first level of coverage here. The excess-surplus market may also work in combination with a primary market policy to provide what we call a layering of coverage. This market is composed mainly of U.S. companies, but has a healthy mix of foreign companies who do business in this country. Companies are licensed to do business in their State of domicile, but generally they are allowed to operate in other States on what is known as a non-admitted basis.

This allowed greater freedom in the rates charged, and the wording of the specific coverages being offered. The excess-surplus market provides the innovation, creativity, and elasticity the industry needs to meet the insurance needs of new and unique businesses as well as providing higher limits of liability so necessary in today's litigious society.

This market can act as a primary insurer for those lines of business or specific accounts that cannot be accommodated in either the primary or excess markets. However, the major purpose of this market is to ensure insurance. It provides the ultimate limit of cov-

erage. Most of the customers of this market are insurance companies.

Reinsurance enables companies to provide a greater volume of coverage and variety of risk. Most times in negotiating with the reinsurer, the originating insurance company decides how much exposure from a book of business it will absorb. The balance of the book goes to the reinsurer. By negotiating with the reinsurer, the originating company decides how much of the exposure it will absorb. The balance goes to the reinsurer. An individual account may choose to self-insure the exposures and limits of liability that would normally be absorbed by the primary insurance market, and reinsure the balance. Most reinsurers are foreign. However, the number of U.S. domestic companies has been growing.

While there are variations on these themes, these are the main components. The health cf each market segment affects the other. If the primary market constricts, more business will be forced into the excess and surplus market, and possibly the reinsurance market. That may mean higher prices, change in coverage, but most often with the desired limits of liability. When capacity shrinks at the top level, the pressure is felt down the line.

Fewer clients can be accommodated. Limits of liability cannot be as fully secured. The price will increase. Marginal lines of insurance, and/or certain types of risks may not be written at all. The current market situation has both elements.

In the late 1970's, a number of new reinsurance companies were formed, and an influx of capital came into the reinsurance marketplace. This provided almost instant capacity. Additionally, the primary market was recovering from a capacity shortage it faced in the early to mid 1970's. The more capacity, the more you can write both in liability limits and the kinds of the risk.

Interest rates were high, creating an incentive for insurance companies to attract capital for investment purposes. The U.S. dollar was not strong, but foreign currencies were. Thus, the U.S. market was very attractive.

These economic factors were being felt at the primary level as well. Large commercial clients wanted to hang onto as many insurance dollars up front so that they, too, could take advantage of the high yield interest rates. Insurers, to keep and attract more business, for they, too, wanted cash flow for investment purposes, kept offering lower prices and more coverage. Some even ventured into new lines of insurance, most notably the pollution liability area.

Once in motion, the cycle fed on itself, fueled by the economics at the time. Soon interest earnings leveled off, the dollar gained remarkable strength, foreign currencies weakened, and the gravy train was over. The insurance industry had its market adjustment just as when recently the stock market took a downward readjustment of over 31 points in one day. It just so happens that insurance industry adjustments take longer to occur and balance.

Another important side of the this dilemma is the loss picture. The loss experience finally surpassed the industry's ability to attract capital and make up shortfalls between the price charged and the loss experienced by class of business. In addition to rate inadequacy, there were undeniable trends developing in the litigation area. The most notable and far-reaching were the varied implica-

tions of pollution exposures. We will not go into detail in this area since the subcommittee is quite familiar with the position of PIA and other insurance industry members who have testified before you on the Superfund.

Another area where notable change took place was liquor law liability. A number of court cases involving owners of drinking establishments, bartenders, companies sponsoring employee functions at which alcohol was served, and even private citizens hosting parties held these persons to varying degrees of accountability for the bodily injury and/or property damage subsequently caused by patrons, employees, and guests who had imbibed too much.

PIA does not call into question society's shift in attitude on the issue of drunk driving. We have been very active in making the public more conscious of its responsibility with regard to drinking and driving. However, the fallout has substantially changed the nature of the risk for liquor law liability insurance.

The erosion of sovereign immunity continues at all levels of government. The Federal Government recognizes this itself. This is the major reason a special task force headed by the Justice Department has been formed to address the issue of tort law and the Federal Government's exposure. The agent orange case is a prime example of the considerable change made to the formation and rights of class action suits, and the Government's liability to military personnel even in war. Municipalities and States have been hit just as hard, if not harder, in every way, from prison conditions to landfills.

Products liability and medical malpractice problems, which first hit the headlines in the 1970's, never fully went away. Again, these lines are in the news because of tight markets and rising prices. Product liability tort reform is still not a reality, and doctors continue to be held to a higher degree of accountability.

The nature of these and other previously insured risks are now unknown, either because it is changing so rapidly that past experience can no longer appropriately apply and/or because we discover new elements to it each day. Under these conditions, the insurance industry is at a loss to deal with them. Add to that a lack of overall capacity and the ability to respond is either greatly reduced or eliminated.

The end result is that we have basically two market problems. There is the market pressure caused by a lack of capacity. Time and capital infusion will arrest this dislocation. However, there is also a market pressure that results from an inability of this industry to properly apply its trade, actuarial principles, in order to identify the boundaries, nature, and cost of certain exposures.

For these risks, capacity recovery alone will not help. There must be at least two additional changes. First, tort reform to set reasonable boundaries to recovery, and second, there must be some appropriate government enforcement of existing regulatory and legislative oversight of these activities to eliminate the undesirable players.

For the pure capacity side of the problem, a return to the sound principles of accurate underwriting and pricing will nurture the recovery and maintain a stable market. PIA firmly believes that if these tools are used properly, a fair and stable market can be pro-

vided for most of our commercial clients. Bargain basement prices are hard to resist, but the problem is that this leads to significant adjustments in the availability and affordability of insurance every several years. The business community would do well to opt for steady, gradual price increases instead.

The client's right to as stable a market as possible can also be improved by placing controls on insurer cancellations of accounts midterm and/or midterm premium increases. In October 1985, PIA adopted several national policy statements regarding these. We believe that midterm premium increases are wholly unjustified unless there has been some change to the account, for example, adding coverage, increasing values, etc.

After being in effect for 60 days, a policy should not be canceled midterm unless there is a material change to the risk that would render it uninsurable under the existing contract, or unless facts come to light that were unknown when the risk was written that would have materially affected the initial underwriting decisions. Nonpayment of premium would, of course, be another legitimate reason for midterm cancellation.

We recognize the problem an insurer can encounter when its reinsurances has been canceled. Should that be the reason for the midterm cancellation, it should be discussed with the appropriate State insurance regulator, and an orderly plan of action developed. We are discussing this latter suggestion with our carriers to come to a mutually agreeable treatment of this aspect.

The time given for a notice of cancellation and nonrenewal is important too. PIA's positions suggest a 30-day notice. We recognize that there may be cases where an insurer may wish to expedite these notices. Such exceptions should be discussed with the appropriate State insurance commissioner.

When and how a renewal quote is delivered affects the client's right and the duty of agents and brokers to shop the market. We have suggested a time frame in which this should be accomplished, and that the quotation should specify any change in insuring agreements.

Ideally, these standards would be met voluntarily. However, most in the insurance industry concede that some degree of mandation is necessary. To this end, PIA is working with the NAIC, individual companies, company trade associations, and State legislators. The level of cooperation from all parties is good. Resolution should be achieved by the end of the States' 1986 legislative session.

These protections help our clients more in the future than now. Immediate relief is also needed here. PIA, along with other members of the industry, are creating various levels of Market Assistance Programs, called MAPs. From PIA's view, there are three levels to MAP's: market analysis, which can uncover trends and burgeoning problems; information hot lines, which can be used by agents or consumers to inquire about whether coverage for their account can be placed and where; and MAP, formalized structures of identifying markets, and the placement of business within them.

Some degree of market dislocation occurs because an agent may have lost his particular market, and is also unaware of an agent or broker who may have one. Once this open market is identified, the

agent can arrange a brokerage agreement with the insurance producer or company that does have the market. This does not add any cost to the insured.

It does mean a probably lessening of commission earning for the originating agent. But some commission is better than none. We have submitted a copy of PIA's Hard Market Manual that addresses these points to Chairman Florio. Additional copies can be obtained upon request. PIA is working with the rest of the industry to implement these MAPs.

To assist our State/regional affiliates in designing programs along these lines, and to familiarize them with the requirements of noncancellation models, PIA has just concluded our Annual National State Legislative Conference. The issue of, and solutions for, insurance availability/affordability were the main focus. Also, a copy of PIA's presentation made on behalf of all producer trade associations before a Senate Commerce Committee staff briefing has been provided to Chairman Florio. Copies are available upon request.

Tough markets challenge and bring to the forefront the creativity of agents and brokers in structuring insurance arrangements that meet the needs of their clients. In addition to piecing various levels of insurance together, agents and brokers are exploring self-insurance and captive formations with their clients. These methods are not for all clients. But given life in the seventies as a result of market difficulties then, alternative insuring mechanisms are here to stay.

PIA believes that the traditional insurance method is the best approach. However, when that can't be achieved, we assist our clients in either structuring their own program, or placing them in an existing group. This demands a great deal of expertise on the part of the agent and broker, but learning new areas is a basic requirement of our job. To this end, PIA is currently sponsoring a seminar on captives for our members to learn how they operate, the legal responsibilities they have, their client has, and the captive manager has to both of them.

As stated previously previously, not all market problems will disappear with the introduction of more capital. Serious study of, and reform of the problems that exist in the civil justice system must be undertaken. This is where Congres can show leadership and effect change.

PIA, as are many others, is involved in a number of efforts. We have joined with our clients trade groups in seeking a fair and equitable resolution.

One area of reform that PIA has supported for quite some time is the review and possible decrease of mandated financial responsibility, FR, laws at the different levels of government. It should be remembered that FR limits are not a cap on liability, nor do wrongdoers avoid having their business or personal assets placed at risk if the injury/damage is great enough. In some instances, Government views FR limits as a self-policing mechanism, a substitute for Government oversight. In effect. this is an attempt to make the insurance industry a Government policing mechanism.

This is an inappropriate role for the private sector, and one this industry doesn't want. All this places an artificial pressure on in-

surance capacity. There are only so many dollars to go around, and if insureds are going to be forced to purchase higher and higher limits, then there will be fewer and fewer the insurance industry can accommodate.

This was readily seen in the Motor Carrier problem. PIA heard of market problems as early as April 1984, from agents/brokers who specialize in the field. This was reported in the May 1984, issue of our magazine, Professional Agent. Additionally, we brought this to the attention of Congress in our several hearing appearances. PIA would respectfully request that this subcommittee encourage a congressional review of all Federal laws and regulations which impose FR limits.

Another long-term solution involves changes in the insurance contracts our industry offers. This is the cleanest and quickest way for the industry to bring some ease to these insurance risks with long-tail exposure and/or sensitivity to changing legal interpretations. Much has been written about the introduction of the new Commercial General Liability policy, both the occurrence, and the new claims made. A copy of PIA's recently released paper on this issue has been submitted to Chairman Florio. Copies are available upon request.

In sum, PIA believes that with the recent changes ISO has made to this entire program, we can support its introduction. We believe it will provide some ease to current market dislocations. The products and the CGL program will need to be carefully monitored and perfected as their experience in the marketplace grows. Without the program, market problems will be exacerbated.

PIA, as did others, worked closely with ISO in suggesting improvements to the program. The NAIC has done extensive and successful work in furthering those improvements. It is our hope that insurance regulators will now find the package of policy changes acceptable.

PIA has long-standing commitment to the State regulation of insurance. We believe it serves the consumer best in that it can respond to problems more quickly and precisely than can the Federal Government.

All regulatory segments at every level of government, particularly those overseeing financial industries, are finding that the nature of the business they are regulating and the technology demands are changing rapidly. Hence, there needs to be a commitment from State government that insurance regulation will keep professional pace with the industry. Appointments of insurance commissioners should be done with care. Persons should be selected that truly wish to be regulators rather than bide time before going on to the next political stepping stone.

NAIC is developing the technology and talent to keep improving the standard of State regulations. PIA applauds these efforts and supports them at the national and State level.

The current system of insurance insolvency protection has served insurance consumers well. However, the industry recognizes updating is needed. A number of proposals for change have surfaced in the last 2 years. PIA is preparing a major position paper on both these issues. It will be discussed at the PIA National Board of Di-

rectors Meeting, February 25, 1986. We will be happy to share this document with you at that time.

The cause of this market cycle is not singular. The solutions in the short term will not be complete. The long-term resolutions bring with them a strong need for commitment to act, and the involvement of every one of us at different levels.

PIA believes that the focus Congress is placing on this issue is healthy. It heightens the sense of commitment to resolve problems for those who wish to keep the current status of McCarran-Ferguson intact. Also, Congress can more clearly identify what role it should/can play.

PIA says again, what can be done for the immediacy of the problem is already underway. Congress can best serve as a leader in the long-term tort solutions.

PIA again thanks the subcommittee for its invitation to speak, and its attention in reading our submissions. Thank you, Mr. Chairman, for this opportunity.

Mr. FLORIO. Thank you.

Mr. Satagaj.

STATEMENT OF JOHN S. SATAGAJ

Mr. SATAGAJ. Thank you, my name is John Satagaj, and I am president of the Small Business Legislative Council. SBLC is a permanent coalition of approximately 88 trade associations and our sole purpose is to represent the interests of small business in national policy matters. In order to be a member of the coalition, at least 70 percent of an association's membership dues must be derived from small firms. Our 88 members represent over 4 million small businesses.

One of the striking features of SBLC is the fact we represent the breadth and depth of small business. We represent a diverse range of interests which, of course, only reflects the fact small businesses dominate almost all sectors of the economy.

What makes SBLC work, and what makes our testimony so interesting, is the fact we do find many issues in common by nature of our common denominator of small business, and I can say without hesitation, liability insurance is rapidly rising to the top of the list as a concern for all small firms, whatever the nature of their business, if it isn't already at the top of their list.

Within the small business community, we have seen several issues which coalesce the community and move them to action in unison. In the mid-70's tax rates were a major concern. In the late seventies, our concern was a voice for small business, and we obtained a White House Conference and laws such as the Regulatory Flexibility Act. In the early eighties we started the battle for deficit reduction. In fact, over a longer term taxes and the deficit have been the traditional one-two on our priority list.

Liability insurance has pushed its way to the top of the pack and is pulling the community together. As you may know, we are currently in the midst of regional meetings leading up to a national White House Conference on Small Business this August here in Washington. At these local meetings, at least on per State, small business owners have an opportunity to vote on issues to shape an

agenda for the national meeting. At the outset, certain issues categories were established and briefing papers were prepared. Insurance was not among these issues. Now some two dozen meetings later insurance has its own session and a diverse range of recommendations have come forth from these sessions.

We, in the small business community, feel we are betwixt and between on this issue. Actually our problem is quite simple. Insurance is a cost of doing business. When the cost of insurance doubles, triples or quadruples, it takes a substantial bite out of the thin layer of income we call profit. If you have studied the profit and loss statement of any small firm, you know unexpected items such as this are what upset the apple cart and start the chain of events rolling which result in a business closing its doors. You never seem to catch up.

We have been deeply involved in identifying the source and extent of the problem since it surfaced in force last fall. We held a major conference on December 11 and heard presentations by the legal profession, the insurance industry and government. We have a second national conference scheduled for March 24–25.

Our member associations have been gathering data on their individual industries. Appended to this testimony are statements by five of our member groups. They represent a cross-section of small businesses.

The surveys show a clear trend. Premiums are increasing at exponential rates; 50, 70, and 150 percent increases are not unusual. Of greater concern, many firms are electing to go bare and forego any coverage. It is difficult to guess how long such a strategy will work. The results of these surveys demonstrate the depth of this crisis.

The individual stories bring the problem closer to home. A recent story in "Newsday" carried a summary of our members' stories and a copy is appended to my testimony. The litany of these anecdotes is long. One thing is certain, we can document with hard data the cost to stay in business.

We say we are betwixt and between because we don't believe we are a substantial contributor to the problem and really haven't heard anybody point the finger at us and say small businesses are careless. From the preliminary data we have seen, the "claims against" history for our member groups is very good.

Instead, we see several factors contributing to the problem. The first is the mind set of our society at this time. In a sense we have become a litigious society. There is always the feeling of " Well, I'll get mine, they can afford it." The ubiquitous "they" most likely translates into the insurance companies. Although the subject of insurance coverage is generally not discussed with juries, we can't help but wonder how many jurors could you find that didn't have the thought in the back of their minds that insurance will cover this case.

We believe tort reform is necessary. In SBLC, we have heard the trial lawyers present their case, and we have listened to Assistant Attorney General Willard who heads up an interagency task force on tort reform. The size of awards, the contingency fee arrangement, the methodology of class action suits and probably, most importantly, the causes of action available to plaintiffs, all add to the

problem. A plaintiff can sue just about anybody remotely involved in a "negligence" situation, and I use that term loosely, in search of a deep pocket. With a broad strict liability statue or case law, the burden of proof has been reduced substantially.

We are not saying throw the baby out with the bath water. To be sure, there are plenty of examples of wrongs made right only because of the system we have in place. We are suggesting, however, the process has outpaced the economics of justice. Society has to balance our individual protection against the need for a working economy. While we are not suggesting it is necessary it be an even balance, the system has pushed us too far in one direction.

We feel the insurance industry has played a role in the current crisis as well. Within our group, we have heard testimony from this industry and again we come to the conclusion, the scale is not completely broken but is out of balance. Much of our concern is rooted in the belief the insurance industry might have taken its eye off the ball, the insurance business.

Mergers, acquisitions, and investments have stretched some companies further than they would like to admit. These problems, coupled with an overreaction to isolated incidents have pushed premiums to the current level. We do not believe our claims record justifies the current premiums.

These are the problems we see, but where do the solutions lie? Generally, small business owners shudder at the thought of Federal regulation. It is not a concept which sits well with them. Further, the two main contributors to the problem, the tort system and insurance regulation, have been tradition areas for State activity. As such we believe much of the reform could take place at the State level, but I stress they could.

This is now a national problem, and demands national attention. We believe we must explore the possibilities of Federal action both for tort reform and insurance regulation. As early as December we had called upon the President to set up a National Commission to develop recommendations for action. We urge Congress to do the same.

We have no magic solution and we know no one group should shoulder the blame for the current situation, but we do have a crisis.

We are willing to meet anytime to find solutions but there is little we can do without help. The sources of the problem are not under our direct control. We need our assistance, otherwise this problem will result in severe damage to the small business community.

Thank you for this opportunity.

[Testimony resumes on p. 430.]

[Attachments to Mr. Satagai prepared statements follow:]

Automotive Service Councils, Inc.

DIRECT REPLY TO:
Donald A. Randall, Washington Attorney
321 D Street, N.E.
Washington, D.C. 20002 Tel (202) 543-1440

188 Industrial Drive, Suite 112 Elmhurst, Illinois 60126 (312) 530-2330

LIABILITY INSURANCE DATA
FROM AUTOMOTIVE SERVICE COUNCILS, INC. MEMBERS
January 28, 1986

Results from a survey of 143 members produced the following information:

I.*	Total members with premium increases	55.24%
A.	Premium increased without change in coverage or carrier	31.47%
B.**	Premium increased, owner forced to reduce coverage to afford insurance	16.08%
C.	Premium increased, owner went to different carrier for lower rates	7.69%
II.	Insurance company decreased coverage	.70%
III.***	Insurance company cancelled policy	41.26%
A.	Insurance company cancelled policy; owner got new carrier at a higher premium	21.68%
B.	Insurance company cancelled policy; owner got new policy with a different carrier but with less coverage for a higher premium	10.49%
C.	Insurance company cancelled policy; owner presently has no coverage	6.29%
D.	Insurance company cancelled policy; owner obtained coverage with another carrier for a lower premium	.70%
E.	Insurance company went bankrupt, moved, etc.; owner forced to seek new carrier	2.10%
IV.	Owner happy with insurance carrier & reports no premium increase or cancellation	2.80%

* Average premium increase out of 115 owners who reported an increase (not including effective increases where premium increased accompanied by decreased coverage) 42.44%

Highest premium increase 164%
Lowest premium increase 4%

A non-profit Association representing THE PROFESSIONALS IN AUTOMOTIVE SERVICE

** Average coverage decrease of 19 owners who reported decreasing coverage 31.69%

Highest premium decrease 90%
Lowest premium decrease 7%

*** Based on owner-responses, the following insurance companies would not insure them at any cost.

1) Onion Group, Inc.
2) West Bend Insurance Co.
3) State Farm
4) SAFECO
5) Kemper
6) Nationwide
7) Chicago Insurance Co.
8) Consolidated American
9) Valley Pacific
10) Farmers Company
11) General Accident
12) Travelers Insurance Co.
13) Royal Insurance Co.
14) Trans America
15) Midwestern Insurance Co.
16) Pennsylvania Manufacturers Assoc.
17) United Community
18) Harleysville Insurance Co.
19) Statesman's Insurance
20) Fireman's Fund
21) Ohio Casualty Group
22) Fireman's Mutual
23) UCIC

FOR FURTHER INFORMATION, CONTACT DONALD A. RANDALL
WASHINGTON REPRESENTATIVE, AUTOMOTIVE SERVICE COUNCILS, INC.
202/543-1440

NATIONAL TOOLING &
MACHINING ASSOCIATION

9300 LIVINGSTON ROAD, FT WASHINGTON, MD 20744 301/248-6200

TO: John Satagaj, President
Small Business Legislative Council

FROM: Bruce N. Hahn, CAE

SUBJECT: SBLC Liability Insurance Questionnaire

DATE: January 28, 1986

I very much appreciate your offer of using NTMA survey results from the SBLC liability insurance questionnaire in SBLC's testimony before the House Commerce Subcommittee hearings on liability insurance on February 4, 1986. We've had an excellent response (over 200 so far). In order to get some preliminary data to you in the most timely fashion, we counted off the first fifty and tabulated them. Based on those fifty responses from our members (small manufacturers, typically 15-20 employees), the results were as follows:

1. Average 1985 premiums $ 9,455 (46 observations)
   Average 1986 premiums 16,474 (46 observations)
   % increase 74.2%

2. Number of companies having recent claims -
   2 out of 45 (4.4%) (average claim $466)

3. Average premium for those changing carriers -
   1985: 4,714
   1986: 7,924
   average increase 68.1%

4. Number unable to get liability insurance at any price -
   3 (6%)

BNH/mw
cc: Matt Coffey
Lee Ryan
Frank Langway

NMSA

NATIONAL MOVING AND STORAGE ASSOCIATION

"Over 60 Years of Service to the Moving and Storage Industry"

T. Peter Ruane
President

IMPACT OF INSURANCE CRISIS ON THE MOVING AND STORAGE INDUSTRY

The nation's Moving and Storage Industry is suffering from the "Liability Insurance Crisis" as is the trucking industry in general. Because of its unique organizational structure and small business characteristics, the "crisis" if it continues could become a financial disaster for the moving and storage industry.

Through its participation in numerous regional meetings during the last three months, the National Moving and Storage Association (NMSA), has identified the insurance liability crisis as the number one problem facing the small business segment of the moving industry.

Our experience mirrors the situation of general trucking and other impacted activities. Astronomical rate increases, cancellations without cause and lack of availability are commonplace. Although we cannot identify the average rate increases for the industry during the past year, horror stories abound.

A representative of a major van line recently indicated he expected their insurance rates to be doubled. During the last week one of our larger association members (West coast) related his experience. For this member, last years premium was approximately $300,000. Being aware of the insurance turmoil and recognizing a substantial segment of his business is conducted in Alaska, he anticipated an increase to $650,000. After extensive researching their broker placed the business at $1,200,000 (a 400% increase).

The NMSA office receives frequent calls from members seeking coverage <u>at any price</u>. The moving service is regulated by the federal and state governments, each of whom require liability insurance as a condition of retaining operating authority. Consequently, the moving industry does not enjoy the option of going "bare." It is illegal!

Because of the unique organization of the moving industry: van lines - agents - owner operators costs invariably are passed down to the small business level, the agents and/or owner operator. It is at this level the crisis can become a disaster.

124 South Royal Street, Alexandria, VA 22314
Phone 703/549-9283
TELEX 901803 NMSA WASH

NMSA

NATIONAL MOVING AND STORAGE ASSOCIATION

"Over 60 Years of Service to the Moving and Storage Industry"

T. Peter Ruane
President

Small movers are denied alternatives available to large corporations. They cannot entertain high deductibles to reduce premium levels, nor command the resources to become self insured. In most cases even collective group action has been unobtainable.

A state movers association (South) workers compensation liability insurance pool was forced to close recently because of lack of reinsurance to the group.

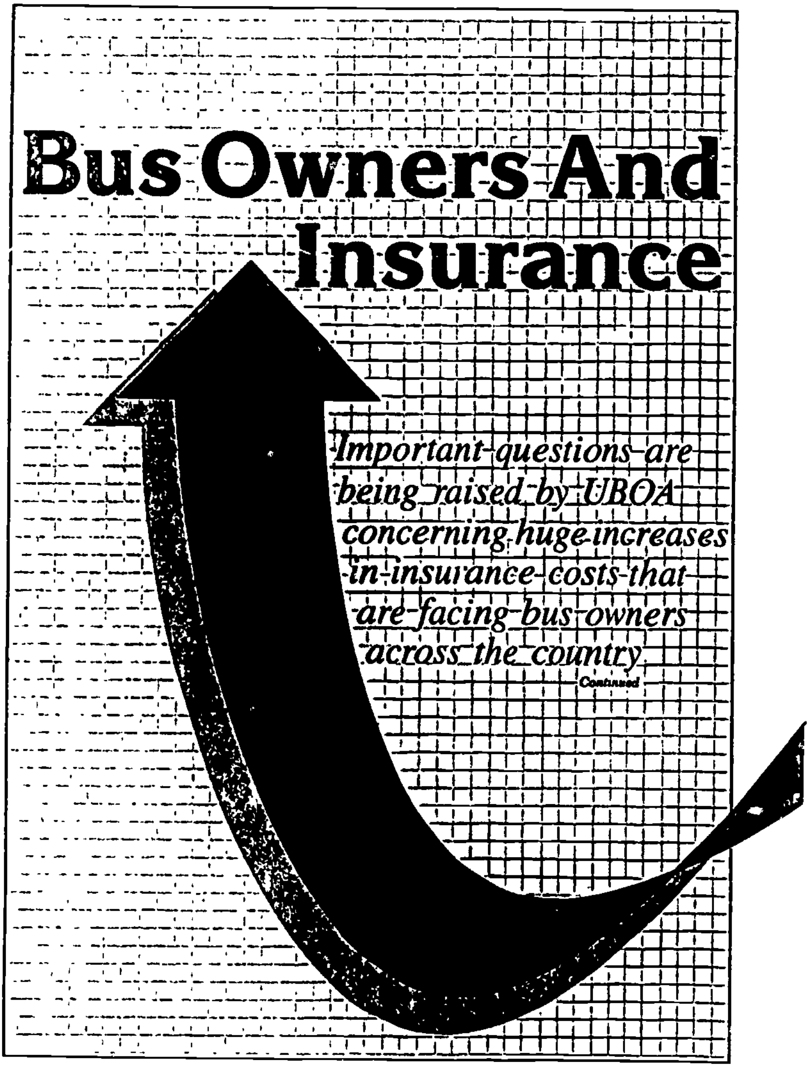
The moving industry apparently is able to place cargo insurance. It is in auto and other liabilities; general, Directors and Officers and the like that the crisis exists.

The theory of insurance is basically sharing of a risk. When liability insurance cannot be obtained, the mechanism for small businesses to share a risk is non-existent. The economic well being of a key component of the nation's economy is threatened.

The causes of the crisis are complex, but certainly a fundamental cause is the functioning of our tort-law system. Whether the fault lies with the judicial, the legal fee systems, the "deep-pocket" syndrome or federal law, NMSA recommends that a full review of the tort-law system is in order. Concurrently, a review of the effectiveness of state insurance regulation should be undertaken and if it is found lacking, federal oversight initiated.

124 South Royal Street, Alexandria, VA 22314
Phone 703/549-9263
TELEX 901803 NMSA WASH

Bus Owners And Insurance



Important questions are being raised by UBOA concerning huge increases in insurance costs that are facing bus owners across the country.

Continued

Editor's note. The following article was prepared by Wayne J. Smith, executive director of United Bus Owners of America. It relates the concerns of bus owners, many of whom have struggled recently to find affordable insurance, as well as actions by UBOA to draw attention to the problems involved and seek solutions.

We did it to ourselves; we shot ourselves in the foot. At least that is the way some in the insurance industry see it.

Were it not so, how could a person testifying for the American Insurance Association say that, even with enormous rate increases, "The current loss ratio continues to reflect the likelihood that losses will exceed premium collected"? Notice the word "current," which must be taken to mean right now, after the increases already have been imposed.

James L. Kimble, senior counsel, was the person testifying for the American Insurance Association before the Subcommittee on Surface Transportation of the U.S. House of Representatives on October 30. He addressed the Bus Act separately, but seemed never to come to grips with the extent to which bus owners are responsible for what is declared to be 41 percent outlay in excess of income for "commercial auto" insurance during 1985.

The experience of United Bus Owners of America (UBOA) has been that our program has been a consistent money maker for insurance providers, we have not imposed losses on providers.

During the Subcommittee hearings, probing questions were directed toward James Kimble. Subcommittee Chairman Glenn Anderson (D-Ca.) spoke from direct experience in the insurance business, and seemed not to be satisfied with the answers.

The congressman heading the subcommittee minority, Bud Shuster (R-Pa.) said, "We have not received testimony today to justify the increase in insurance costs for buses and trucks." Shuster conceded that the insurance industry, as a whole, may face a real problem, but he could not "see that the transportation industry had contributed (to the problem)."

The insurance industry said that loss ratio is affected strongly by "loss adjustment expenses (principally legal defense costs)." Congressman Thomas D. DeLay (R-Tx.) asked when the industry would reverse that loss trend, and when it would begin to "fight frivolous suits." DeLay said lawyer acquaintances had told him they make it a practice to take insurance cases to court, knowing the industry will not fight the claims.

UBOA told Anderson's subcommittee. "During the past few years, UBOA's premiums approximated $58 million annually. Losses incurred during each such period were below 50 percent, resulting in a profit for the insuror."

By contrast, the insurance industry said its losses for commercial auto liability coverage ranged from 109.7 percent in 1980 to 144.3 percent in 1984.

UBOA's testimony did not dispute overall losses; we simply objected to being lumped into the loss listing. We said.

"For the insurance industry as a whole, however, insurors suffered losses when pay-outs exceeded premium income during the insurance price wars that began in 1980. In the face of bus industry losses, insurors naturally chose to concentrate their efforts on areas posing lower potentials of risk than does the motor carrier industry. Even though UBOA's program was profitable to the insuror, we were caught up in the decision of the insurance industry to shift to populations offering greater security

Continued

Bus Owners

Continued

against catastrophic loss. Put differently, insurors decided that if they were to exit the motor carrier industry, it would be done across the board, rather than on a selective basis, that UBOA's program, however healthy, could not be immune to the quarantine against high hazard coverages."

Things may get worse before they get better, but at least we're getting sympathetic attention

Chairman Anderson suggested on October 30 that, legislatively or procedurally, his group may be expected to face up to the insurance problem's prejudicial impact on the motor carrier industry. Just one day earlier, Chairman John C. Danforth (R-Mo.) of the U S. Senate Committee on Commerce, Science and Transportation spent more time on insurance than on any other aspect of the Bus Regulatory Reform Act of 1982 The hearing had been called to examine the results of passage of that Act, and UBOA dealt only in passing with insurance matters. Otherwise, there was discussion of very little else, and Chairman Danforth let it be known that our problem would have further attention from him and his Committee,

From day to day, we are awaiting announcement from the White House on how it will deal with the petition of the Small Business Legislative Council (SBLC, of which NTA is a member) for setting up a "Presidential Insurance Issue Task Force," which would be empowered "to examine the origins of the issue, and to propose a pattern of solutions."

The White House may be expected to seek a solution which will leave unimpaired state jurisdiction over matters regarding regulation of the insurance industry. Reflecting the Reagan Administration viewpoint was testimony before the Anderson Subcommittee that, "I've not seen evidence that there is need for federal action."

Whether before a Presidential task force or in any other forum, UBOA will continue to argue that our (SBLC) letter to the President was factual, and that "the insurance problem is complicated, enormously by the fact that surveillance over the insurance industry's performance is basically the responsibility of the various states"

Whatever action may or may not be taken at the White House or on Capitol Hill, UBOA said to the Anderson Subcommittee that any legislative remedies should be directed toward

1) establishing a federal presence on insurance regulation,

2) proscribing mid term cancellations of coverage except for good cause,

3) determining what constitutes a reasonable limit on total awards for a single occurence, and

4) specifying that an insuror's total liability cannot extend beyond the limits of coverage for a particular occurence

We described to the Subcommittee how UBOA knows bus owners "cannot be isolated, completely, from the real, outside world of insurance, its hazards, its pass throughs"

UBOA conceded that bus owners themselves are obligated to pass through to their riderships the added costs of adequate insurance We acknowledged that our successful petition to the Interstate Commerce Commission (ICC) gave us that exact tool, when the ICC authorized bus owners to add increased insurance costs to their rates and schedules, do-

Continued

Bus Owners

Continued

ing so on just 10 days notice instead of 30 days.

The ICC has taken another very important step by issuing a "Notice of Investigation and Request for Comments" on insurance problems facing the motor carrier industry In that undertaking, UBOA joined with the American Trucking Association to request the ICC to open an investigation, which ICC has approved, and which (in ICC's words) will "determine (1) the extent of the insurance crisis facing the motor carrier industry, (2) the causes of this crisis, and (3) what action, if any, is necessary to alleviate the problem A carrier's certificate or permit remains in effect only if the carrier maintains appropriate insurance The Commission is aware that carriers are experiencing increasing difficulty in obtaining the requisite insurance and that large increases in premiums are being charged to renew existing policies."

NTA members will be interested to know that the ICC expressly requests information on how the crisis is affecting female-owned enterprise.

Having acted both on UBOA's request for insurance related rate increases and on the American Trucking Association's petition for an investigation, the ICC already has a good track record. ICC Chairman Reese H. Taylor polished that record a bit more brightly when, on October 30, he told the Anderson Subcommittee that reform in the bus industry is threatened by the insurance problem. He described how, prior to 1982, the ICC required each applicant to demonstrate public conveniance and necessity before a permit could be issued. Now, he said, entry into the motor carrier industry is being regulated by the cost of insurance, and that insurance barriers are higher than any imposed by the ICC "even at its zenith."

Another extemporaneous statement by Chairman Taylor showed that he does not intend to play games with insurance, and that gypsies will not be allowed to continue to play games with the ICC. He said any commercial vehicle may expect to have its insurance certificate inspected whenever that vehicle is stopped for any purposes, such as weighing, roadside inspection, or traffic violation.

No certificate will be issued to anyone without proper evidence of insurance, and no certificate will be allowed to remain in effect unless it is backed by evidence of insurance. Recently, UBOA had a one-bus member grab a chance to sell the coach as the slow season began. The member wanted to keep the operating authority in place until spring, at which time another coach would be purchased or rented. The ICC would not agree to this. The problem was worked out when the carrier's insuror issued a policy on "named vehicles," and named none

Chairman Taylor said there is a five-step process:

1) the insurance filing is entered into the ICC computer;

2) the insurance carrier notifies the ICC 30 days in advance that coverage is about to lapse;

3) 14-day letter-of-warning is sent to the motor carrier;

4) the motor carrier is given an opportunity to sign a "consent agreement" not to operate for 30 days or until replacement insurance is arranged,

5) insurance is revoked, and motor carrier is served with a court injunction, should operations be continued

Motor carriers are advised not to "run bare" (without insurance, or with the barest minimum). The penalty is \$10,000 for each day of violation

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Bus Owners

Continued

The insurance industry has a point. The argument is that Congress should not legislate minimum liability coverage, that Congress cannot possibly tell what proper coverage might be, that if the ICC and the Department of Transportation are allowed to determine other standards to be met by certificated carriers, DOT should also be free to decide what liability coverage is needed.

Witnesses for the agencies have told Congress that they see the insurance problem not being complicated by the November 19, 1985, increase from $2.5 to $5 million for coaches with capacities greater than 15 passengers plus driver. On the other hand, the insurance industry argues that the increase to $5 million could not come at a worse time, and says it doesn't know if it's needed

On another matter, UBOA agrees with the insurance industry in that we believe there must be a system to shine a light on the problem driver or the license violator Both the insurance industry and UBOA are associate members of the Alliance for Motor Vehicle Administration Telecommunications (AMVAT). Already in place is funding for a "Request for Proposal" Would-be contractors will offer programs for setting up a computer based network, whereby problem drivers and violators will be identified by their licenses, by their photograph (expressed in computer language), or by other means. DOT has estimated that as many as one-in-three commercial drivers may hold more than one driver's license AMVAT will stop that practice

But back to the matter of libel. Peter Gunn, speaking for the Independent Insurance Agents of America, told the Anderson Subcommittee, "Deregulation, high minimum limits of liability coverage along with the owners' and operators' lack of attention to safety have all played a part in the inability of insurance companies to risk their capacity by providing coverage"

Congress deregulates, then the insurance industry, as seen by Chairman Taylor, undertakes to re-regulate.

Minimum limits of coverage are too high, therefore, the insurance industry reduces coverage above the minimum, and charges more than was required for the higher coverage.

"Lack of attention to safety" is the greatest libel No one anywhere has ever had a safety patrol such as that of UBOA What's more, our safe buses have paid profits to insurance providers

The facts are that our safe, profit-paying vehicles are being penalized along with those which are unsafe and unprofitable Justice demands that we be treated according to our performance, not according to the records of the body of insured persons who are the true burden upon society

Label lists available

Label lists of NTA Tour Operator and/or Tour Supplier members are available for quick delivery from the national office in Lexington, Kentucky. Members of NTA may buy either list for $75, while the non-member price is $200. Price includes cost of computer printout, handling and mailing. Lists may be ordered in either alphabetical or zip code order.

To purchase a label list, checks payable to the National Tour Association should be sent to: National Tour Association, 120 Kentucky Avenue, Lexington, KY 40502.

Small Businesses Hard-Pressed

By Harry Berkowitz

When Jennifer Dembia did a maneuver called a one-foot scratch spin at an ice-skating rink in Westwood, N.J., the 10-year-old was doing it at her own risk, according to seven signs that warned: "Lost Insurance. No Liability."

The signs went up when the insurance policy covering accidents was dropped because its price had soared from $3,000 to $20,000.

"I refuse to be bankrupted by the insurance companies," said Fritz Dietl, who has owned the small indoor rink for 28 years. "No rink can afford it."

A liability insurance squeeze has spread through myriad small businesses — from skating rinks to trucking firms, from bars to crane operators. "I cannot think of a business that doesn't already have or won't soon have liability-insurance problems," said Walter Galanty Jr., chairman of the Small Business Legislative Council, a lobbying group of 90 trade associations representing 4 million small businesses.

And unlike large corporations, which can form pools or rely on cash reserves to self-insure, the small businesses have few options other than closing, cutting back operations, or gambling by going without coverage.

When the cost of liability insurance quadrupled for Blue & White Lines Inc. in Altoona, Pa., last year, Dennis R. Long said, he dropped 30 of the 95 buses that drove to New York and other points, laid off 15 employees and raised prices 10 percent.

The problem for bus or trucking companies is heightened because some insurers specializing in those fields, such as Transit Casualty Co. of Los Angeles and Carriers Insurance Co. of Iowa, are folding after several years in which a glut of competition led to a price war.

"There are just a handful of companies writing the business now, so they can demand whatever they want," said Wayne Smith, executive director of the United Bus Owners of America, a trade group based in Washington representing 2,300 bus owners.

Some businesses, including contractors seeking municipal business as well as truck and bus companies, are required to carry insurance. But Galanty said many other types of small businesses are going without. "They don't want a lot of people to know that they don't have liability insurance," he said. "But we're seeing that happen. It's not good for the American economy."

Others are not willing to take the chance.

In 1984, when Dorothy Jodon couldn't get insurance for the riding school she had run for 25 years in State College, Pa., she sold her 12 horses and shut the operation. "I ran a safe operation, I took care of my horses and I took care of the people who ride," said Jodon, who told Newsday she had never been sued. "It's a real blow."

In some industries, those in which lawsuits have mounted, businesses are taking new precautions.

"If you have rats in your home, we will not use certain chemicals that have a little bit higher risk, even if they are more effective," said Steve Shwimmer, president of Fumex Sanitation Inc., a 53-year-old exterminating firm in New Hyde Park, who said his premium rose more than twelvefold this year even though coverage was reduced.

For Atlas Tank Lining and Maintenance in Brooklyn, which installs storage tanks for oil and gasoline, coverage shrank from $21 million to $1 million. "Nobody wants to insure me because I have umpteen-thousand potential risks out there," said William Weidman, Atlas president.

Insurance companies are especially wary about businesses that attract the public in large numbers. The problem is magnified for restaurants, bars and hotels, which also need liquor-liability insurance to cover their responsibility for people who get drunk and have accidents.

Antun's catering hall in Queens stuck buttons on its waiters warning, "I will not serve an apparently intoxicated person," said Joe King, general manager.

Some restaurants are dropping their insurance, said Pat Olson, director of operations for the 300-member Long Island chapter of the New York State Restaurant Association. "They figure they might settle a claim for less than what the insurance costs," Olson said.

The problem has been especially punishing in specialized fields because when an insurer pulls out of the line, it's hard to find a replacement.

The Chubb group of insurance companies pulled out of the skating market early last year. "It has not been profitable," said Edward Darwin, president of Chubb Custom Market Inc. "Skating is risky."

In telephone interviews, however, insurance industry spokesmen would not specify numbers of accidents or losses on skating insurance.

"We're an excellent risk," countered Justine Townsend Smith, executive director of the Ice Skating Institute of America, based in Wilmette, Ill., which is surveying its members to determine the frequency of accidents.

When a major insurance company like Chubb pulls out, a brokerage company like Frank B. Hall & Co. tries to find a substitute — but that has been difficult. "Historically, you found companies willing to write the riskier areas and make bigger profits," said Roger Wade, vice president at Hall, which is based in Westchester. "But the insurance companies are now less prone to taking the risks."

As a result, the companies willing to pick up the clients boost prices exponentially. "It's the same as OPEC," said Dietl, owner of the New Jersey rink that dropped its insurance. "They raised prices and got away with it so they raised them again."

In cases of negligence, the rink remains liable for accidents despite the signs he put up. He said that if he were to lose a big lawsuit he would probably have to file for bankruptcy.

Marilyn Dembia, Jennifer's mother, said she noticed the warning signs, but is not worried about an accident because her daughter takes lessons. "Besides," she said, "it's the only rink around here."

NPA NATIONAL PARKING ASSOCIATION

1112 16th Street N W Suite 2000 Washington D C 20036 (202) 296-4336

January 31st, 1986

Mr. John Satagaj
SBLC
Suite 1201
1025 Vermont Avenue, N.W.
Washington, D.C. 20005

Dear John·

The National Parking Association is a 35 year old Trade Association with over 1,100 members representing Operators, Owners and Builders of Parking Facilities.

The Liability Insurance Crisis is having a serious impact upon Americas Parking Industry. Last December our members were surveyed about the Insurance Crisis and nearly twenty-five percent responded.

Several respondees contend that the high cost of Insurance and their unability to obtain Liability Insurance Coverage . any price could force them out of business.

Our members are disgusted with the way the Nation's Insurance Companies have treated small firms. Although a Parking Company has experienced few or no insurace claims over the past three years, the Insurance Companies nevertheless, have generally tripled the rates or refused coverage.

Our members have been forced to scramble at the eleventh hour, with out warning, to try to find a carrier that would provide insurance coverage for their business at any price.

NPA's survey revealed that the cost of Workmans Compensation coverage has doubled through out the Industry.

Cost Garage/General Liability Insurance has generally tripled.

The cost of Garage Keepers Legal Liability Insurance has also tripled.

It is common for Umbrella Liability Insurance coverage for the parking industry n 1985 to cost from three to five times more than the 1985 premiums with sharpley reduced coverage.

-2-

An Umbrella Policy that took effect at $350,000 now takes effect at one million or two million and the top Umbrella Liability limit has generally been lowered from ten million to five million.

** Anthony V. Vena operates Fisch's Parking in Philadelphia, and his Company was forced to turn to the ASSIGNED RISK PROGRAM run by the state of Pennsylvania. He now pays a huge premium for a fraction of his 1984 coverage even though his firm has an outstanding loss experience record.

Mr. Vena says that his company is in danger of going out of business

** The Parking Place in San Francisco has seen it's Cost Garage/Liability Insurance rise from $3.46 per stall to $10.00 per stall in one year.

** In January 1985, the Professional Parking Corporation in Nashville, Tennessee paid $1.50 per space for Cost Garage/Liability Insurance—Today it's premiums are $10.00 per space for reduced coverage.

** The Republic Parking System in Chatanooga, Tennessee paid $2,200 for five million dollars of Umbrella Coverage in 1984. In 1985, it could only get two million dollars of Umbrella Coverage which cost $38,000. Republic also saw it's Cost Garage/Liability Insurance skyrocket from $40,800 in 1984 to $143,000 in 1985. Despite a very favorable claims record.

** The Loop Parking Company in Minneapolis paid $6,000 in 1984 for a ten million dollar Umbrella Policy. There never was a claim under that coverage, but the Trasport Indemnity Company cancelled the coverage. Loop Parking in 1985 paid $30,000 for grossly reduced Umbrella Coverage.

Sincerely,

Thomas G. Kobus

THOMAS G. KOBUS
Executive Vice President

Mr. FLORIO. Thank you very much.
Ms. Shaine.

STATEMENT OF FRANCES SHAINE

Ms. SHAINE. I am Frances Shaine, Chairman of SPM Manufacturing Corp. in Holyoke, MA. I am appearing on behalf of the U.S. Chamber of Commerce, the world's largest federation of business companies, chambers of commerce, and trade and professional associations. I am a member of the U.S. Chamber's Board of Directors and I serve as chairman of its Council of Small Business which is composed of small business leaders who recommend small business policy to the chamber's board of directors.

The U.S. Chamber appreciates this opportunity to present its views. It is a pleasure for me to be here.

We would like to commend Chairman Florio and the committee for leadership on this issue. It is a very difficult issue for Congress to address for two reasons. First, regulation of the insurance industry is heavily concentrated at the State level, and many actions that are being discussed to address this problem involve changes at the State level. Second, the solution to the problem may well involve changes in the living conditions of some of our sacred cows. Hearings such as this focus attention on the issue, and develop a useful body of information on the concerns of the business community. Although this is a state-regulated business, the major insurance companies are national in coverage and the current problem is national in scope.

Insurance is born of the need to spread risk. Sometimes it is purchased voluntarily by prudent people who are risk-averse. Sometimes it is purchased regulated industries because it is required by law, as a condition of doing business.

Although the high and increasing cost of insurance is not specifically a small business problem, there is no doubt that the cost of insurance is generally a higher percent of overhead for small business then for larger entities.

For some businesses, recent insurance cost increases have become life-threatening.

But the problem is epidemic. At a recent meeting in Boston, Galt Grant, director of risk management for Polaroid, stated he had been unable to obtain insurance coverage for 1986.

I would first like to give you a little bit of history about the chamber's involvement in this issue, then talk about a survey that we have done of our members, and finish with what specific changes the chamber is currently considering.

In October, the chamber's council of small business recommended to the board that the U.S. Chamber address the growing crisis concerning the affordability and availability of liability insurance for the business community. The board approved that recommendation at their November meeting by calling for the establishment of a Blue Ribbon Civil Justice Action Group and encouraging a complete review through the chamber's communication resources.

Since that time, we have undertaken a wide range of activities, including six regional meetings held on January 23. Over 1200 people attended these meetings, which were held in Los Angeles,

Denver, Dallas, Atlanta, Chicago, and New York. We have also established a Clearinghouse on the Liability Crisis. The purpose of the clearinghouse is to provide a "one-stop shop" for information on activities that are taking place in Washington, and what resources are available to help business in specific industries. The clearinghouse will also publish a monthly newsletter. I have included the first two issues in my written remarks, along with a complete list of chamber activities.

I am able to announce today the results of a survey that the chamber has addressed to its members, regarding their problems with liability insurance and what actions they would like the U.S. Chamber to undertake. The survey responses are not entirely complete yet, but I don't anticipate that the percentages I am about to reveal will change significantly. We will send final figures to the Committee when they are available. Current responses exceed 800.

We have found that almost 85 percent of the businesses surveyed have been able to obtain or renew their liability coverage. A full 15 percent have been unable to renew or obtain needed coverage.

About half have had premium increases of between 100 to 500 percent. Becuase of these increases, 32 percent have had lower profits. Liability coverage presents the greatest problem (31 percent), followed closely by product liability insurance (22 percent) and transportation insurance (15 percent).

An incredible 98 percent believe the problem will get worse, and nearly 28 percent have already contacted their state insurance commissioner about their problems. Nearly 17 percent are now going bare, operating their businesses without any liability coverage at all.

The survey continues by exploring their feelings about the current state of the civil justice system. When asked why the member of liability suits and damage awards are increasing, 34 percent said the civil justice system encourages frivolous claims, while 31 percent believe that liability claims are now based on the ability to pay, not on wrongdoing. 98 percent believe the size of awards is excessive in relation to the economic costs arising from injury, and 91 percent believe the number and outcome of claims against their business is unpredictable.

The final question we asked is "Which of the following approaches should the Chamber of Commerce pursue concerning this problem?" The answers were: 25 percent for civil justice reform; 15.5 percent for Federal product liability legislation; 14.9 percent for tort reform; 12 percent for changes in insurance laws and nearly 32 percent for all of the above. Interestingly, the last choice was no action, and not one person checked that response.

The U.S. Chamber is examining several proposals suggested by our members. They include (1) uniform standards of liability for litigated cases, which are consistent with the principle that those who are responsible for harm to the person or property of another should, to the extent of that responsibility, offset the Farm they have done; (2) a reform of the rules of damages, particularly as they relate to non-economic loss and punitive damages; (3) reform of the rules of joint and several liability, contribution and claim reduction; (4) provision for determination of technical issues by increased reliance on independent expert bodies rather than lay

juries; (5) development of cost-effective alternative mechanisms to replace litigation for dispute resolution; and finally, reduction of transaction costs by regulating contingent legal fees.

My State, Massachusetts, is very much in the news today. If you watched Nightline last night you saw the results of a squeeze on a regulated industry, the medical profession. Other regulated industries have similar problems. When insurance is mandated, such as for the handling of hazardous materials, but is available only at high cost or not available at all, solutions must be found.

In these circumstances, or in circumstances where the national infrastructure is at risk, statutory solutions seem imperative. Some sort of reinsurance program may be necessary, where not national goals are on issue.

I thank the subcommittee for their attention, and will be happy to answer any questions concerning my statement.

Thank you.

[The prepared statement and attachments to Mr. Shaine's oral testimony follow:]

PREPARED STATEMENT OF CHAMBER OF COMMERCE OF THE UNITED STATES

I am Frances Shaine, chairman of SPM Manufacturing Corp. in Holyoke, MA. I am appearing on behalf of the U.S. Chamber of Commerce, the World's largest federation of business companies, chambers of commerce, and trade and professional associations. I am a member of the U.S. Chamber's Board of Directors, and I serve as chairman of its council of small business which is composed of small business leaders who recommend small business policy to the Chamber's Board of Directors.

The Chamber appreciates this opportunity to present its views. It is a pleasure for me to be here.

Not long ago, I read a column in "USA Today, by Susan Percy of Atlanta. I would like to share a portion of that with you. I know of no better way to express the irony and frustration of today's topic than through this piece of satire.

Ms. Percy writes, "Now that lawsuiting has become a national pasttime, here are some people I intend to sue:

"The Haagen-Dazs ice cream people, who make the chocolate-chocolate chip flavor. I am suing to recover the $52.45 I paid recently for a black wool skirt. After consuming a quart of their ice cream, I discovered the skirt would not zip or button. Haagen-Dazs is clearly negligent; no warning of any such consequences appeared on the carton. I am asking another $182.50 to cover the cost of the shoes, blouse and sweater that go with the skirt. And of course, $1.5 million for pain and suffering.

"The Atlanta Humane Society. I have adopted three different cats from these people, and each one of them has developed fleas. I am pretty sure I see a pattern. I am asking $4,000 for pest control services, veterinarians' fees and professional cleaning. Just $1 million for suffering, since this is a nonprofit organization."

While these are humorous and exaggerated examples of our overly litigious society, these anecdotes emphasize a dangerous crisis that is threatening the economic well-being of our country. They underscore the fact that we are faced with a liability crisis in America.

The present crunch is causing severe hardships on businesses, professions, and municipal and local governments.

Many underlying causes have contributed to the present situation Everyone is suing. Judges and juries appear to be overly generous to plaintiffs. Courts are broadening the legal doctrine of strict liability, so that businesses, professional people and their insurers may be made to pay for mishaps, even if the proof of fault is tenuous.

Although other factors may have contributed to the present situation, there is a concensus that the insurance crunch is merely a manifestation of a greater problem in our judicial system. The number of lawsuits in recent years has increased almost geometrically. Between 1978 and 1983, a record 12 million cases were filed. Most cases are filed in State courts. However, from 1940 to 1982, civil cases in Federal Courts increased sixfold, from 35,000 to 206,000. Federal product liability suits more than doubled from 1978 to 1984. In 1984, there was one private civil lawsuit for every 15 Americans.

As the number of cases filed has increased, the average dollar amount of settlements and awards has increased as well. In 1983, there were 360 personal injury cases with awards of $1 million or more—this is 13 times as many as in 1975. The average product liability award has increased from $345,000 to over $1 million in the last 10 years, and the average medical malpractice award approached $950,000 last year.

Not only is the present tort system costly to producers and manufacturers, it is inefficient as well. Studies have shown that lawyers more often than not receive over half the dollars which are awarded to plaintiffs in these cases. A Rand Institute study has shown that in asbestos litigation, of the average $101,000 award or settlement, lawyers received $62,000.

Aside from the increasing costs of litigation, expanded tort doctrines have held defendant corporations liable for injuries that could not have been foreseen.

The doctrine of strict liability is expanding—and industries are being held to higher standards of care than that of the reasonable man. This is a result of the increased complexity of society and the belief that there should be financial redress for all injuries regardless of reasonableness.

You have probably heard about the overweight man with a history of coronary disease who suffered a heart attack while trying to start a sears lawn mower. He sued Sears, charging that too much fore was required to yank the mower's pull rope. The jury awarded him $1.2 million, plus damages of $550,000.

This notion of compensation without fault encourages actions against unidentified defendants and deep pocket defendants, that is, businesses, utilities, and cities and counties often become defendants in lawsuits because they can afford to pay or have insurance rather than because they are at fault.

Overall, fault, which historically has been the prerequisite to recovery of damages in the tort system—is no longer a prerequisite. More and more often, courts and juries have been permitted to speculate how the redesign of a product or the use of a substitute material might have prevented harm or injury to a plaintiff. Unfortunately, such decisions often fail to take into account the ramifications of these decisions and to consider how this second-guessing poses potentially, more serious threats to the consuming public.

The number of defenses against liability are waning—being replaced by a concept of absolute liability. These unexpected liabilities, as well as other losses, threaten the ability of insurance underwriters to provide the coverage needed in all lines of insurance. The insurance industry understandably is avoiding underwriting risks that it cannot identify.

As a result, liability insurance shortages are occurring everywhere—from the highly publicized medical malpractice insurance of physicians, to the lack of liability coverage for municipalities, to the small business that is being forced to go bare or to go bankrupt.

Not only is there a shortage in the availability of liability insurance, but also there are significantly increased commercial and professional liability insurance rates, restrictions in coverage, and denials or cancellations of liability insurance.

In 1984 insurance companies paid out $1.18 in losses for every $1 paid in insurance premiums. In 1984 property and casualty insurers had $21 billion in underwriting losses and $3.8 billion in net losses—the first net losses since 1906, the year of the San Francisco earthquake.

And there is not much hope on the horizon—indications now are that the demand for coverage in 1985 will exceed the insurance industry's capacity to provide coverage by $7 billion. The shortfall may go as high as $62 billion by 1987, according to some experts.

Present troubles also have been exacerbated by practices within the industry. Fierce competition in the late 1970's led to the issuance of imprudent policies at low premiums. When interest rates were high, premiums were invested. However, in 1984, interest rates collapsed, just as underwriting losses swelled.

Also, insurance regulators question insurance companies if they write additional business when the ratio for premiums to surplus funds needed to satisfy claims exceeds three to one. This causes an insurer to abandon some clients to reserve its capacity for its best risks—thus, an availability shortage is created.

Because of recent premium increases, more selective underwriting, and some coverage limitations, insurance companies are anticipating improvements. However, the market will remain very tight until fundamental and far-reaching changes are made.

In the short run, positive actions can be taken. The business owner can reassess his current insurance coverage—considering higher deductibles, going bare in certain areas, and improving his risk management. The small business owner also c

consolidate brokerage, maintain a good underwriter, or shop around. In addition, he can consider buying insurance through a trade or professional association or by joining a cooperative.

Like Band-Aids, such stop gap efforts will give only temporary relief. For long-term relief, major surgery may be in order. Some States, such as Montana and California, already have placed caps on the amount of punitive damages that may be awarded for pain and suffering. Nine states thus far have enacted laws setting limits on awards in medical malpractice suits. Recently, the United States Supreme Court dismissed a challenge to a California State law that limits the fees lawyers may collect in medical malpractice cases. Similar measures should be considered by other States.

At the October 1985 meeting of the U.S. Chamber's Council of Small Business, the Council members recommended that the liability insurance developments merited the U.S. Chamber's attention. The members of the Council also believed that the civil court system was out of control and was a major contributing factor to the increased expense and decreased availability of liability insurance.

Their concerns were discussed at the November 1985 meeting of the U.S. Chamber's Board of Directors. The Board directed that a Blue Ribbon Civil Justice Action Group be formed to encourage changes in the civil justice system, and that the Chamber use all its communication resources—television, radio, and print media—to publicize information about this situation. I have included at the end of my testimony a complete list of activities the Chamber has undertaken.

The Chamber has undertaken a survey of its members to determine the impact of higher premiums and, in some cases lower coverage of their liability insurance policies. I am pleased to be able to share—for the first time publicly—these survey results. I also should add that this survey is an ongoing process, and additional responses are anticipated, but we do not anticipate the findings will change significantly. A copy of our survey is attached.

We have found that almost 83 percent of the businesses surveyed have been able to obtain or renew their liability coverage. Only 14 percent have been unable to renew or obtain needed coverage. Nearly 3 percent did not respond. Over 40 percent have had premium increases of between 100 to 500 percent, while nearly 10 percent had increases of over 500 percent. Because of there increases, 20 percent have had lower profits and 17 percent have raised the price of their goods or services.

General liability coverage presents the greatest problem, 60 percent, followed closely by product, 40 percent; officer and director, 31 percent; and transportation 30 percent. Nearly 35 percent are considering going bare—operating their businesses without any liability coverage at all.

Unfortunately, an incredible 95 percent believe the problem will get worse. Only 14 percent have contacted their State insurance commissioner about their problems.

The survey continues by exploring opinions on the current state of the civil justice system. When asked why the number of liability suits and damage awards is increasing, 93 percent said the civil justice system encourages frivolous claims, while 84 percent believe that liability is based on the ability to pay, not on wrongdoing. Ninety-six percent believe the size of awards is excessive in relation to the economic costs arising from injury, and 90 percent believe the number of and outcome of claims against their business are unpredictable.

The final question we asked is which of the following approaches should the Chamber of Commerce pursue concerning this problem? The answers were: 39 percent for civil justice reform; 63 percent for Federal product liability legislation; 23 percent for tort reform; 42 percent for changes in insurance laws; and, nearly 48 percent for all of the above. Interestingly, the last choice was no action and only one person checked that response.

These survey findings confirm in greater detail the recommendations from the State meetings preceding the White House Conference on Small Business. Two of the three leading recommendations concern this issue. The number one recommendation of the first 27 State meetings is tort reform, and product liability reform is the third leading recommendation.

We also must reemphasize the need to enact Federal product liability legislation. With the present patchwork of laws, manufacturers and retailers are unable to comply with the conflicting standards that the States impose. One uniform Federal product liability law would end our lottery system of justice, where a plaintiff may recover an enormous sum for damages in one State, while a similar claimant in another State receives no compensation. We must remedy a system which does not promote safety but instead redistributes enormous sums of money to attorneys who perpetuate this system.

Also, in the area of environmental liability, the Federal Government has expanded significantly its regulation of business activities for the purported purpose of environmental protection. However, these laws and regulations have effected protracted and costly litigation. For example, under current law, Superfund liability is retroactive and open-ended.

Finally, the business community is showing an increasing interest in the medical professional liability problem. Escalating numbers of claims and increases in the size of settlements and awards are pushing up health care costs and causing changes in the practice patterns of physicians. The changes ultimately affect society-at-large as higher costs are passed on in the form of higher fees and health insurance premiums. The fact that medical professional liability problems are causing health care costs to rise is even more significant given the intensive efforts in the public and private sectors to contain health care costs.

Employers are, of course, well aware of the impact of rising expenses of employee group health care plans on their costs of doing business, and thus, ultimately on their ability to compete. On the other hand, most employers may not be aware of the impact of medical professional liability on those health plan costs. In 1983, employers paid $65.3 billion in health insurance premiums for their employees.

The impact of medical professional liability on these premiums, while difficult to measure precisely, is significant. Estimates of the impact range from $2 billion to as high as $14 billion or higher. Thus, a significant percentage of the employer's health insurance premium may be attributable to defensive medicine, i.e., the ordering of additional tests and treatment procedures as a response to the increased risk of a professional liability claim, and increased professional liability insurance costs.

We must search for reforms sufficient to reverse the trend of increasing litigation and to solve the pressing liability problems that were not anticipated.

We must consider the many variations of alternative dispute resolution—arbitration, and mediation—all methods that seek to avoid crowded court dockets, higher legal fees, and liability premiums.

Alternative dispute resolution has become increasingly more popular. Nine States currently use arbitration for resolving disputes.

I have outlined certain broad areas in which civil justice reform is appropriate. Undoubtedly, if Congress and the State legislatures would address these issues, there would be a positive effect on the ability of businesses to obtain insurance and/or obtain insurance at affordable rates.

This is not to imply, however, that other remedies should not be explored. We must depend on State regulations to guarantee that insurance policies are firm and to soften the harsh cyclical nature of the insurance underwriting business, without imposing undue burdens on the insurance industry. Similarly, we must make efforts to assist the underwriters in identifying groups that may be covered appropriately on a group basis. Finally, we must assist business in its time of great need, to expand its search for insurance coverage at affordable rates.

Thank you for the consideration of our views. I will be happy to respond to any questions.

ATTACHMENT

U.S. CHAMBER ACTIVITIES TO DATE

- August 24th - "It's Your Business" program on the "crowded courts."
- September, 1985 - Nation's Business poll on "medical malpractice reform."
- October 3rd - Council of Small Business meets and recommends the formation of an "Emergency Task Force on the Liability Crisis."
- October 24th - "Emergency Task Force on the Liability Crisis" meets and makes recommendations to the Board of Directors.
- November, 1985 - Business Advocate cover story on the "liability crisis."
- November 13th - Board of Directors recommends the establishment of a "Civil Justice Action Group" and "public awareness" campaign.
- November 15th - Association executives meet with Chamber staff to promote association participation in future activities.
- November 18th - "Nation's Business Today" features interviews with business executives.
- November 24th - "It's Your Business" program on "medical malpractice liability."
- November 26th - Chamber hosts an association briefing on the "liability crisis."
- December, 1985 - "Small Business Journal" television program features a commentary on the "liability crisis."
- December 1st - "It's Your Business" program on "product liability."
- December 3rd - Government and Regulatory Affairs Committee addresses the product liability issue.
- December 3rd - Chamber testifies before the Senate Commerce Subcommittee on Business, Trade and Tourism.
- December 16th - "Steering Committee on the Liability Crisis" holds its first meeting.
- December 17th - "Ask Washington" program on the "liability crisis."
- December 17th - Chamber hosts a Washington corporate representatives briefing on the "liability crisis."
- January, 1986 - Combined meeting of Washington corporate and trade association representatives.
- January 23, 1986 - Chamber regional conferences on the "liability crisis."
- January 28, 1986 - "Steering Committee on the Liability Crisis" holds its second meeting.
- February, 1986 - Nation's Business cover story on the "liability crisis."

PENDING U.S. CHAMBER ACTIVITIES

- February, 1986 - "Civil Justice Action Group" to be selected.
- April 30-May 1, 1986 - Chamber co-sponsorship of a "National Symposium on Civil Justice Issues," in cooperation with Fordham University Law School and the Insurance Information Institute.

The U S Chamber's National Clearinghouse on the

LIABILITY CRISIS

MEMBERSHIP SURVEY

(Responses to this survey will be used only in aggregate.)

1. What is your business or profession?

2. How many people do you employ?

3. Have you you been able to renew/obtain the liability insurance you need?
   83.1% Yes 14.1% No

4. If yes have your premiums risen by?

   23.1% 10 - 50%
   17.5% 51 - 100%
   41.4% 101 - 500%
   9.9% More than 500%

5. What effect has this increase had, if any, on your business or profession? Lowered profits: 20.5%; Raised Prices: 16.7%; None: 5.2%

6. What types of liability coverage, if any, present problems to you? (Check all that apply.)

   60.3% General (Casualty)
   14.7% Environmental (including hazardous waste)
   13.2% Professional (Architects, Engineers, CPA's etc.)
   7.0% Medical Malpractice
   29.6% Transportation
   30.8% Officers and Directors
   40.7% Product
   10.4% Other (please specify)

7. Do you see the problem, if any, getting better or worse for you?

   2.0% Better 95% Worse 3.5% (No response)

8. What alternatives if any are you pursuing? (Check all that apply.)

   24.2% Dropping products or services
   47.3% Paying higher premiums/raising prices accordingly
   3.3% Other (please specify)
   20.3% Self Insurance
   17.3% Closing your business
   35.5% Going Bare

9. Have you contacted your state insurance commissioner about this issue?
   14.5% Yes 48.2% No

10. In your opinion, why are the number of liability suits and damage awards increasing? (Check all that apply.)
   4.2% Professional and business communities are less competent
   93.2% The civil justice system encourages frivolous claims
   84.5% Liability is based on ability to pay, not wrongdoing
   60.0% Consumers have unrealistic expectations
   28.1% Other (please specify)

1615 H Street, N W Washington, D C 20062 (202) 463-5528

11. In relation to economic costs arising from injury, the size of awards is:

0% too low   1.5% about right   96.0% excessive

12. The number and outcome of liability claims against your business or profession is:

8.2% predictable   90% unpredictable

13. Which of the following approaches, if any, to this liability problem should the U.S. Chamber of Commerce pursue? (Check all that apply.)

39.1% Civil justice reform
22.9% Tort reform
0% None
62.8% Federal product liability reform
42.1% Changes in insurance law
47.6% All of the Above
.8% Other (please specify)

NAME: ______

COMPANY: ______

ADDRESS: ______

TELEPHONE: ______

RETURN SURVEY TO: LIABILITY CRISIS PROJECT
BGP DEPT./U.S. CHAMBER OF COMMERCE
1615 H STREET, N.W./WASHINGTON, D.C. 20062

Mr. FLORIO. Thank you very much.

Let me express the committee's appreciation to all of the witnesses. I would like to ask a few questions, perhaps the first question to the two representatives from the insurance agents' organizations.

First of all, I am pleased that you are as confused as we are about what the statistical information means in terms of evaluating overall profitability in the industry. One thing that seems to particularly be wisdom around here in the last few years is that the market is actually the determiner of value. How is it, therefore, that you can justify or explain to us how insurance stocks are at the very high level in an industry that apparently is not supposed to be doing very well.

Is there some sense—something we are missing that the market is picking up; that justifies the high value of insurance stocks or the stock market today?

Mr. RUE. Well, Mr. Chairman, I won't purport to be any kind of guru on the stock market, but I would think that the possibility that insurance companies, with these rate increases, that the potential does exist for improvement in profitability of companies, and people that buy these stocks may, in fact, be sensing that, before it actually happens.

Mr. FLORIO. Can you share with us any observations you may have as to what we can foresee that will improve profitability in the insurance industry that is not the case now?

Mr. RUE. Well, certainly our business is a very cyclical business, as you know, and in the time that I have been in this business, I have been through a few of these up and down cycles where prices were very low, and subsequently went up again, and I would believe that with the rise in prices; that we are going to see a return to profitability in companies and also I believe a return to stability in the marketplace.

Mr. FLORIO. Would that dictate that perhaps the last item on the questionnaire which no one said, don't do anything, might have been the approach that should have been followed?

Mr. RUE. Well, no, I would say notwithstanding that, I believe that there are certain problems that I stated in my testimony that do have to be addressed; that is, tort reform, areas of the Superfund, and Federal requirements for limits of financial responsibility.

I believe these are things that are certainly going to have to be addressed in the long run in order to at least provide for affordability in certain areas of insurance.

Mr. BAILEY. I think I might add the marketplace anticipated that many of these reforms in the tort system and in the learning process of the companies in the pricing of their products may improve the overall situation of profitability as well as the fact that the insurance companies themselves are dealing in other areas outside of insurance today which offers profitability to them in many of the instances where the prices of their stocks have increased. It is also those companies who are heavily involved in the areas like health insurance, which up to this point have been really profitable for them.

Mr. FLORIO. One more question for the two of you, the discussion that Mr. Lent had with one of the previous witnesses about the antitrust exemption, do either of you have any sense that no one is asking the question as to why the antitrust exemption should exist in this clearly interstate business when all other aspects of business operated, no one asks why someone should have an antitrust exemption?

Here the thrust of the questions are why should we even consider removing the antitrust exemption when it is clear that is the exception to the rule? Have you thought through or is there anyone that thought through any benefits that could be derived by the insurance industry from removing the exemption so as to allow for a higher degree of competition to allow the marketplace forces to operate in a more effective way?

Mr. BAILEY. Well, I think that the recent down cycle of the market doesn't give a lot of credibility to the idea of more competitiveness in the marketplace. I think perhaps it has been too much competitiveness in the marketplace recently. But I think that the protection of the insurance industry gets or allows them to get together and to poll their knowledge and pool underwriting results, which should in effect give them greater credibility for the industry to price their products.

They are still at liberty to price their products as they see fit, and by individual companies—but it does give a pooling of this idea of large numbers, and what large numbers tells us as far as the ability to forecast what the premiums should be.

Mr. FLORIO. That this is the very opposite of the experience we are having now. We don't have that. The insurance industry is saying that it has no capability of making those determinations, notwithstanding their unique capability to share information between potential competitors.

Mr. BAILEY. We have not been totally pleased with the sharing of statistics either, but we think that that potential is there.

Mr. FLORIO. Mr. Satagaj, on the commercial insurance movement in the last couple of years, many States have totally deregulated—the rationale, of course, being that unlike insurance with an individual, with an insurance company and a business, the theory was that arm's length negotiation can take place, and there is relatively equal bargaining capability. That may be the case when you are talking about IBM or AT&T, but do your companies have some question about the legitimacy of the basic assumptions of equal bargaining capability between insurance companies and particularly small businesses that have justified deregulation in the area of commercial insurance?

Mr. SATAGAJ. Well, we are certainly not dealing on an even playing field in our negotiations with insurance companies. The results show that what is happening is simply you find you are going to an insurance company, they inform you what next year's premium is going to be and that is the end of the subject; case closed. So there is no real negotiation—if regulation is giving us a competitive edge, we don't see it at this time.

There is simply nobody there. There is no second option to it. That is really the answer at this point. We are not gaining anything from it.

Mr. FLORIO. We have a copy of the Chamber of Commerce's statement before the Senate, December 3, 1985. There is a suggestion about considering reinsurance options that would allow the Federal Government to assume certain risk, promote self-help plans. These are suggestions for the Federal Government. Improve company risk management. I know, I didn't hear today. You are talking about Federal reinsurance options.

Is that something that has been thought through again or do you continue to feel that reinsurance—Federal actions in the area of reinsurance should be desirable.

Ms. SHAINE. Congressman, I did mention that certainly where national goals are involved, that the subject of Federal reinsurance need to be addressed, and it seems to me that as a result of our further deliberations, you may find that there are other areas which that should be addressed, and all of those matters are still under consideration at the chamber.

Mr. FLORIO. On the Federal Reinsurance Program provisions or options that you suggest, would any of them be those that Mr. Hunter and Mr. Nader suggested to us at our last hearing?

Ms. SHAINE. I haven't read their testimony, so I can't really comment on that.

Mr. LENT. I might just suggest that the Chamber of Commerce might have dropped that Federal Government reinsurance idea in view of what is happening with our budget, Gramm-Rudman and so forth. The experience at the Federal level in selling insurance and handling insurance at least in flood and crime and crop insurance, was that the Federal Government took a bath. So I don't think there are going to be too many Members of Congress who are going to jump at the idea of taking on what Lloyd's of London has run away from; namely, getting into the reinsurance business which seems to be kind of tricky business and one in which losses are very much on the horizon.

I would like to ask Mr. Satagaj, in testimony that Mr. Rue submitted to this committee, he says that the PIA is working with the National Association of Insurance Commissioners, individual companies trade associations and State legislators to resolve these problems of affordability and availability. He says, further, that "resolution should be achieved by the end of the State's 1986 legislative session."

There are also, as we know, numerous—I know in New York State, my State, many commissions and committees are examining this issue. In your opinion, what progress is being made at the State level?

You can report to us on addressing these affordability and availability problems.

Mr. SATAGAJ. Short term we are seeing some results. I forget the correct terminology, assigned risk pools are helping, MFA. We are getting short-term results in working on State-by-State basis. I think the process, if you are involved with any national reform that takes place at the State level, is even much slower than dealing with the Congress and getting some results, because you are working with 50 States agreeing on some plan, so the progress is slow.

We are doing it. It is progress, but for somebody who has insurance premium problems coming up today, telling them wait for next year or next year's legislature, we are going to have the problem solved isn't a good solution. Take the local area, the Virginia legislature is out of session or going out of session shortly, so you are not going to get a solution.

Yes, we are working. Everyone is working, but it is slow.

Mr. LENT. Mr. Bailey, you make the point that your association's president, Mr. Taylor, said that underwriters are trying in most cases to find a way to get out of writing a new piece of business. If an insurance company can make a profit selling a specific type of insurance, why would it not be wiiling to sell that insurance?

Mr. BAILEY. Well, I think the obvious answer is that it would be willing to sell that insurance if it can make a profit on that line of insurance.

The problem is that the companies have tightened all of their underwriting. It is something that has invaded the entire area of underwriting. We seem to talk always in terms of difficulty to place liability risk. But in truth and in fact each day we are confronted with the renewal of across-the-board accounts, both property insurance, the liability insurance, the fleet insurance.

The problem that has been created for the insurance industry partly by their own doing is such that their underwriting all the time in a very difficult way. They are trying, it seems to us, many times to find reasons not to renew and account rather than to renew that account.

You have to also understand that in the—for example, as these companies work so hard to protect their ratings in Best's Guide, which everyone looks to as a company's rating. They work so hard to protect those ratings. You know there is a proscribed formula they should not write about more than two times premium to surplus. That is a rather strange type of thing because when the market was soft, and the rates were extremely low, they could assume much, much greater risk for much less premium. And yet that was all right.

The ratio to surplus, today, when they are trying to get the premium back up to where they should be, or where they say they should be for risk, that they are insuring, this causes them to have to cut down on the amount of risk that they are assuming the physical number of accounts that they are renewing.

So it becomes a very difficult matter which we deal with in every area of insurance, not just in the liability area.

Mr. COATS. Mr. Bailey, isn't it also true that even though there are lines of insurance, that insurance companies would like to write today, that there is a capacity problem in the industry, lack of adequate reinsurance, and the need to, in some cases, get reserves and ratios in better balance? But isn't that capacity problem preventing some insurance firms from writing?

Mr. BAILEY. Yes.

Mr. COATS. Coverage that otherwise would be profitable?

Mr. BAILEY. Yes, that is true.

Mr. FLORIO. I forget who it was that made reference to merger policy on acquisitions, presumably in the context of insurance companies in their capacity as financial institutions becoming involved.

Is it the case that financing such an endeavor—does that detract from the capability of having the reserves the gentleman from Indiana talked about, because you have got your money into investment, and therefore you can't have the reserves needed, surplus needed for premiums.

Is there any correlation or relationship between participation or involvement in acquisitions or investment decisions, and therefore reduction of the capacity to become involved in insurance.

Mr. BAILEY. Mr. Chairman, I really can't answer that because I don't know. I suspect that generally, so long as these investment opportunities continue to constitute the asset value of that company, it shouldn't terribly affect their capacity to write business.

But I honestly do not know the answer.

Mr. COATS. My off-the-cuff response to that would be that unless the insurance company that is buying out another company is buying a financially solid company, that is not going to happen. They are not going to merge with or buy an insurance company that is in worse shape than they are or that has a lower reserve or less capacity and put them in a more disadvantageous position.

The goal of the merger ought to be to increase capacity, to increase the ability to write more insurance, to write better coverage. I can foresee a situation where perhaps on short-term situations you might be willing to weaken your reserves somewhat in order to expand your future coverage, but in most cases, I would think a prudent investment would dictate that those are the very first thing you look at, and that in most cases you do make that acquisition in order to expand your ability.

Mr. TAUZIN. Mr. Chairman, I was speaking to a Texaco official the other day and asked him if he thought that injury award had gotten excessive lately, and they had a rather strong opinion on that subject.

I think, however, the incident most recently that sort of emphasizes the problems we are getting into in this area, involved the visit I had from a representative of the American Medical Association, who often comes to see me because of our committee's jurisdiction in that area, to discuss issues. Please don't, as a government, start legislating and limiting doctors' fees in this country. But this was a peculiar visit because the representative was in to see me about cosponsoring a piece of legislation to limit attorney fees in malpractice cases, which I think sort of amplified the manner in which we are not only getting into this problem, but approaching it.

The Chamber of Commerce is here testifying about a survey, awfully interesting result with reference to businesses belonging to the chamber, and, Mr. Satagaj, with reference to small business problems with insurance, it occurred to me the chamber—most small business groups also represent small businesses that include insurance companies, and big businesses, including insurance companies and attorney firms, so that some of the players within that area that impact upon the problems associated with the area, and also members of your association which make it very interesting to see some of your recommendations.

Congress is looking at limitation of liability statutes. Right now in Merchant Marine and Fisheries, we are looking at limitation of

shipowner liability. We are looking at the Jones Act reform on liability for accidents and injuries on vessels' offshore activities. As you know, product liability is before the Congress.

In many of these instances, the Congress and State legislatures are being asked to come in and actually fix some cap on liability as a solution to the insurance crisis that is descending upon many towns and businesses in the country.

You didn't speak to liability caps to a large degree, but I would like to hear particularly your two observations on—Ms. Shaine first—what is the chamber's position on a national system of liability caps?

Ms. SHAINE. It is still under analysis. I can give you an important response, if you want to hear one.

Mr. TAUZIN. Yes.

Ms. SHAINE. Seems to me that we are approaching that kind of circumstance, and that it recognize that what one does carries with it an inherent risk, and it has to be made obvious. So, if you get on an airplane, part of that is your own risk, so perhaps then a cap on what is paid out although you should, seems to me, have the opportunity to get further insurance on your own for that kind of circumstance.

If caps, however, are done on a State-by-State basis, then the venue for suit will be chosen based on where the caps are.

Mr. TAUZIN. Mr. Satagaj.

Mr. SATAGAJ. We are looking at it as well. We are looking at also—we are definitely entertaining that. Probably our main reservation at this point, again, is how you set a figure as the cap itself, and whether it is done on national or State level. We consider that in that range of tort reform. Definitely cap is one issue.

Mr. TAUZIN. Let's talk about for a second if indeed a cap may be one of the recommendations made. I was speaking before the Maritime Association Bar in New York about a month ago, and asked members there—we are talking about the ship owner liability—where they are experiencing problems with malpractice insurance. And of course, they are. It is a growing problem for attorneys as well.

I think when it reaches crisis proportions in the Bar, you may see even more ability to deal with the problem, but when you discuss caps, almost immediately the question comes up; is there a trade in automatically built or loss of defense to liability. Let me be specific.

We went to no-fault insurance and workman compensation in this country a long time ago because we felt that a worker shouldn't be denied some recovery because of all the defense that businesses or employers would throw up against to recover such as, well, you assumed risk—when I work next to the next guy or you consider it to the accident because of some small, tiny 1 percent feature. So you get no recovery at all.

We felt, wait a minute. There ought to be recovery in all cases, but we can't—the liability—so that work—now recovery where they hit them in the head with the hammer or anybody does it for liability—there is a limit on what they are to recover in most jurisdictions.

Is there, in your view, some—can we discuss on that level some systems of caps limiting liability in a trade for which some defense to liabilities would be surrendered?

Mr. SATAGAJ. My answer is more a question of priorities. I think that for us the case of a lot of problems is the liability statutes under which you can get an award, so I think our preference would be to work on that instead of cap, because a cap or the award is merely a symptom of cause, the cause being the particular cause of action you can sue under. So, in that sense it is not a tradeoff. It is a question or priorities.

Our priority between the two would be to go to the cause of action—can't do that, then go to cap.

Ms. SHAINE. That is a reasonable set of priorities as each of you have said. The whole panacea of solutions is open to examination.

Mr. FLORIO. Time has expired. The gentleman from Texas.

Mr. FIELDS. Thank you, Mr. Chairman.

Mr. Chairman, I am fortunate to have a relationship with one of the witnesses, Mr. Bailey, since we serve on the board of trustees of Baylor University together. So, I am thankful that we have this relationship, Mr. Bailey.

We listened to the problems discussed among the different witnesses, and it really brings a question to my mind. It was one thing I tried to ask the panel earlier; that is where should this problem be addressed? Should it be addressed in our instance in Austin, TX, or should it be addressed here, and if it should be addressed in Texas, what is the State of Texas doing about this particular problem?

Mr. BAILEY. My answer is, of course, that it should be addressed on the State level, I think, where it properly belongs. I think that the States are in a better position to deal with the problems within their States because the rules of law and evidence that apply in all of these cases that are identified by the States are something that they are accustomed to dealing with, and can deal with better.

We are trying there—our State board has taken some very hard stands as far as cancellations are concerned, as far as interim premium adjustments are concerned. We have set up one of these market assistance programs, and this type of thing is taking place and also there is quite an effort going on within our State.

And I think all States for some form of tort reform, will give an opportunity for the States to react to these things.

I think one thing we have to understand, it is very easy for us to place blame on the State legislatures or on the State insurance bodies, because rates were allowed to be charged over the past few years that were inadequate, and in effect caused the companies to suffer great losses. Now, it is easy to place blame there.

We say that States have the authority to see that the rates are not unreasonably low, or unreasonably high, but I think we also have to realize, as a political reality, that it is very difficult to mandate the rates not be that low, when in fact the people are thrilled to death to see the rates going that low.

I can testify to you how to experience that for the early 1980's up to about 1984, my customers were thrilled to death with policies of insurance that I was taking to them and the rates that we were charging them, because they were almost without fail somewhere

in the area of 60 percent below what would be manually decried in those cases.

And I have seen many policies of insurance, programs going at 90 percent of manual rates, and no one ever complained at those points, and so that puts a great deal of political pressure on the insurance departments, and on legislatures of those States, not to jump up and down and say, hey, you have got to raise those prices.

You yourselves, I think, would admit that it would be very difficult for you when a constituent came and said my insurance company tells me they will give me this insurance 40 percent less than you charge, but you won't let them, so these things become very complex issues.

And it is very easy to say that the proper regulation was not achieved at the state level or among the regulatory authorities, but I think that we have been through that period, and I think that we are now in a period of restoration policy rating, and I think that a lot of lessons have been learned hopefully that will not be forgotten for a long time.

I, personally, think that the marketplace will ultimately solve this problem to a large degree. There may be some forms of liability coverage that will never be available again. Right now I would pick pollution liability as the prime example, unless specific changes are made in the joint and several responsibilities.

But, basically, I think the market will come back, will come back more readily than we anticipate, because what we must remember is the bottom line is the companies must get back to a break-even or profitmaking situation, and when that occurs, you are going to see these markets return. That is not to say we shouldn't do everything we possibly can at the present time.

I sit there, I am sure the other gentleman Mr. Rue does. We labor every day. We are the ones that have to go out and tell you that we cannot find coverage, or that there is a very high price for what we are bringing to you, but these facts must be faced until we can get the market in a position again where we can underwrite with sensibility and with reason, and I think that is what is being done at the present time.

Mr. FIELDS. Thank you, Mr. Chairman.

Mr. FLORIO. The time of the gentleman has expired.

Mr. Luken, we are pleased to have you with us. Mr. Luken has asked permission to ask quick questions. Without objection, Mr. Luken is recognized.

Mr. LUKEN. I thank the Chairman.

We have dealt with this in the other subcommittee, the Health and Environment Subcommittee on Products Liability, and the two are intertwined—obviously, the subject of insurance and the subject of liability and, of course, products liability. And I want to congratulate the Chairman for a very timely hearing. This is a real service that he is pushing forward on this.

In the Senate, Senator Danforth has a bill, and I just want to confine my questions, since the rest have been covered very well, to getting an opinion or some thoughts from you as to what you think is happening on that legislation.

Senator Danforth has a bill, I believe, which provides for tort reform as an alternative way to go on a products liability case, or a

so-called administrative remedy, which really isn't administrative but it does eliminate the strict liability issue.

Do you have any comments on that, Mr. Rue, Mr. Satagaj?

Mr. SATAGAJ. I do. We do have a position on it. We support the product liability bill that is going through.

As you probably know, back a little while ago, it lost momentum. It failed to get enough votes to get out of the Senate Commerce Committee over there. The recent attention that is being addressed to this issue has given it a new life, and it is moving forward.

It has changed radically. Perhaps from the business community standpoint, it is not what we originally would have liked to have seen, but it is progress. It is moving forward.

One of the things that was changed that might be a little trouble, I think, to the small business segment in terms of getting the small businesses out of the chain.

Typically, the lawsuit starts with suing everybody in sight, including retailer on up the line, and that is one of the concerns we have, of course, is that we are pulled into a lot of liability suits where we don't feel that the small business person in that situation should be pulled into it, and that is one of the concerns we still have, but generally we are supporting what is going forward.

My understanding is there is a good chance it will move forward in the Senate.

Mr. LUKEN. I would like to see some progress.

Mr. Rue, do you want to add anything?

Mr. RUE. I was just going to say that PIA also supports tort reform in the product liability area. I think it is important that we address areas like this, because it is the problem of affordability that these pieces of legislation hopefully will address.

Again, the marketplace in time may in fact make more of these coverages available. The problem is that prices may continue to be very high for many consumers.

Mr. LUKEN. Of course, part of it is the tort reform, which has been around, kicking around for a long time. It boils down to some of the things the gentleman from Louisiana mentioned, and you were discussing, limitation or at least a sliding scale, you might say a sliding scale for contingency fees and limitations on punitive damages.

Personally, I don't have too much of a problem with those. I would have problems with totally eliminating contingency fees. I think that would deny many people representation. At the moment, I would be looking favorably on some kind of a sliding scale.

In any event, some effort at tort reform, and I am glad to see that is moving, and I thank the chairman.

I will yield back the balance of my time. I thank the chairman for the opportunity to appear, especially to listen today.

Mr. FLORIO. Thank you very much.

Does the gentleman from Louisiana seek recognition?

Mr. TAUZIN. Thank you, Mr. Chairman.

I know we have combined the panels. This is the last one.

I wonder if anybody on this panel is ready to support the notion that either at the State or Federal levels there ought to be a limitation on the outside investments of insurance companies.

As you know, the earlier panel discussed that, and you did too, Mr. Bailey, the fact that while investments were going good, premium payors benefited, but when the investments go bad, you get sort of a double whammy.

You not only have to catch up with the premium increases that you didn't incur, but you also have to start subsidizing the losses on the other side of the insurance programs, the insurance companies' whole business operations in effect. They are looking for some help somewhere, and the premium payors are the easiest place to go when business is bad.

We limit utility company investments. I realize insurance is not a utility.

Do any of you support the notion or suggest that we ought to look at that area on the national level or perhaps on the State level?

Mr. BAILEY. I wouldn't support the idea necessarily. I would point out a part of the complication of this is that so many of the States have laws relating to the investment of insurance companies that operate within those States, requiring specific amounts or percentages to be invested within that State, and of course, that would not necessarily preclude stating the type of investments that they might make, but I think that that while it could seem good under certain circumstances, could also preclude them from making some very wise investments in other circumstances.

Mr. RUE. I do believe that this is addressed quite adequately at the State levels as far as the investments the companies can make, in looking at their financial statements and their list of their portfolios and holdings which would suggest that they are probably pretty conservative.

Mr. FLORIO. Will the gentleman yield?

Mr. TAUZIN. Yes.

Mr. FLORIO. I thought the gentleman before in his previous round of questioning was going to ask about anyone's enthusiasm for limits on liability in return for administrative compensation using the workmen's compensation system.

Can I ask the question in that form? Any enthusiasm, since there is so much enthusiasm, particularly not only this panel but most of the panels that we have had today, and in previous cases, there is so much enthusiasm for limiting liability. There is clearly a point beyond which you can limit it when you arrive at unfair outcomes. People are obviously injured.

Is there any sense that the approach of reducing access to the courts through the litigation process, the traditional adversarial process, in return for some sort of an easier administrative process whereby people who are injured can receive compensation? Is this something that perhaps the Chamber of Commerce has given any thought to, or anyone else?

Ms. SHAINE. The proposal that there be arbitration groups areas, expert witnesses dealing with these matters rather than going through a long and involved litigation process appears to be one of the courses that the chamber is going to endorse, although that move is before the board next week, and it seems to me that that is along the line that you are talking about.

If the process were simpler, if the arbitration process were simpler than access to the courts often is then perhaps that is a tradeoff.

Mr. FLORIO. You are talking about a national system?

Ms. SHAINE. No.

Mr. FLORIO. You are talking about national product liability laws?

Ms. SHAINE. Yes.

Mr. FLORIO. Why would we not be talking about a national system as a tradeoff?

Ms. SHAINE. You ask a good question. The preference of most business people is that insurance regulation continue to be at the State level.

Mr. FLORIO. We are not talking about insurance regulation as such. We are talking about national limits on tort liability.

Ms. SHAINE. No, although even if those were set at a national level, that would not prohibit one from implementation of an arbitration process at the State levels.

Mr. FLORIO. I understand what you are saying. I am not even sure you think that the logic is parallel.

Let me just raise one last question, because I think it is important to realize that in the enthusiasm that all seem to have for limiting liability, there is a point beyond which we go and can go, and in many instances have gone already, that doesn't make a lot of sense to the American people. For example, truck insurance; I think there is the perception out there in the public that something is amiss on the Nation's highways.

We see in the States there is this movement to try to pull over trucks, and the information I have in my State and a few other States is that two out of every three trucks that are pulled over don't have front-end brakes. Whether that is a combination of regulatory failings, and in some instances it is, because the bureau of motor carriers safety is not enforcing its own regulations with regard to front brakes, whether it is deregulation, which is in a sense putting a premium on the bottom line, and if you have to trade off on maintenance, that is a problem.

The perception is that the administration is going to be advocating the ICC be eliminated, which passes on fitness of carriers, so it is clear that something is happening which may very well be making the situation more dangerous.

Now, we or someone comes along and says it is clearly a more dangerous situation out there. There is more probability of people being injured, but our response to this problem is going to be limit liability for those who may very well be clearly injured.

You reach a point where social instability occurs, if there are too many people feeling that injuries are occurring that there is no realistic remedy, so the balance has to be struck, and I think that is what we are trying to do.

I thank the gentleman for yielding.

Mr. TAUZIN. I would like to just follow up on that, however, in that there have been some balances established in that process in some of the no-fault systems that may deserve some attention.

For example, in many of the no-fault insurance systems, there is a thing called a threshold, where the threshold of injury must be

breached before you have access to the courts. Otherwise you are back in either the arbitration or the automatic award position, so that you eliminate a lot of the litigation in most of the ordinary injury or damage claims, and yet you preserve for the severely injured individual in one of those cases a right of recovery beyond the ordinary limitation of liability that might be in a no-fault system, so that there are some checkpoints and remedies I think we can discuss as we talk about limitation liability. And one of those is indeed trade.

Do you want an administrative process? Do you want a national one? When will it go into effect? At what threshold will it stop, and the injured citizen who is so severely injured has a higher rate of recovery?

Those are all things I hope, frankly, in the recommendations you will be making to us on the national level, you think and discuss, because indeed the chairman is right. The balance is going to be critical here.

It is not just a question whether we can insure America. It is also a question whether or not we are going to do it in a fair manner, that adequately compensates someone who is injured again through somebody else's fault.

Mr. LUKEN. Will the gentleman yield?

Mr. TAUZIN. Yes.

Mr. LUKEN. In connection with the chairman's question, could I ask the chairman, does your question in regard to the tradeoff include an option for giving up the right to go on the tort as opposed to going on the administrative, or does it go both ways?

Mr. FLORIO. If the gentleman would yield, the point I am trying to raise is that limitations of liability should not be end goals in themselves. The overall goal should be to reduce injury so that liability awards would not occur, or if injury does occur, people are appropriately compensated, and that all of those considerations have to be rolled into the discussion.

If one is going to talk about structural limitations, statutory limitations on liability, one has to acknowledge the fact that there may be legitimate injury that has to be compensated for, and in attempting to make the system more efficient, it may be that there are other things that can be done to provide for efficiency of addressing injury, and an admistrative system might be one of those types of things.

So all I am suggesting is that in our enthusiasm, not only in this panel and the previous panels in our previous hearings, to deal with liability and product liability limitations, in the interest of the insurance industry, in the interests of the business community that is dealing with these very high insurance fees, that we have got to also take into account appropriate systems for dealing with legitimate injury that perhaps haven't been addressed with as much force as perhaps they could be.

Mr. LUKEN. If you will yield back further, I think the gentleman makes a very cogent point, and I was only dealing with the narrow issue on the liability, which I am sure you will be discussing in your further responses, because as I understand it, again, in the Senate that the earlier bill did not provide the option.

But now the administrative remedy is only an option for a plaintiff or a claimant, that the claimant has 90 days or 60 days or some period of time in which the claimant can go the tort route, can go to the court route, and failing to exercise that right within a certain time or give such notice, then he or she must go the so-called administrative route.

I think that looms as a very important point in arriving at any consensus on legislative remedy.

Mr. FLORIO. The time of the gentleman has expired.

Mr. Bailey.

Mr. BAILEY. Mr. Chairman, I just wanted to comment. I think your observation is very good concerning something being done to alleviate the losses before they ever occur.

You raised this question earlier with the panel here. Was there any correlation, you said, between the efforts to prevent loss and ultimate affordability and availability of insurance, and certainly that should be something that does have a direct correlation.

I have a client right now who is just finishing about $900,000 worth of work at that particular business dealing with life safety measures, the installation of sprinkler systems in places of high population of employees, various things of this type. Because they were willing to do that, they are able to get insurance, and they are able to get it at at least a more reasonable cost than they would have been able to, had they not done those things.

For years the insurance industry has placed great emphasis on safety engineering, but in times of soft market, they became relatively unimportant. We would receive these recommendations from safety engineers, and we would sort of toss them aside, the insured would. No big deal, and the insurance company wasn't pressing them to get these things done, because they were willing to underwrite their business, because of cash flow.

Now we are seeing a turn around in that. We are seeing safety engineering come back into its proper perspective, I think, and the customers are being told these things must be done, if you are to have insurance. All in all, it will produce a better place for people to work. It will reduce losses in the future, but it is a difficult thing to go through.

Mr. FLORIO. Let me just raise the point. I agree with what should be done in the hard market. You have described what happens in the soft market, but is it the case that anyone is doing that at this point?

The people I talk to, the business people I talk to, are saying that the insurance industry people don't want to talk to us at all, that if it were a matter of installing sprinklers, if it was a matter of providing for a higher degree of protection in environmental matters, we would do it.

Let them give us some direction, but the industry doesn't appear to want to do that, and as I made comment earlier, the feeling on the part of some people is that the only way that that will happen, that the insurance industry will take on some of those traditionally regarded public responsibilities, will be when someone else is willing to do it, some potential competitor.

Mr. BAILEY. I think some of both is going on. They are coming back and reinstituting these safety precaution measures and safety

engineering. Surely some of them are simply saying we don't want to talk to you at all. There has been an overreaction.

We have never denied that as part of agents, because we see it on a daily basis, what we think is overreaction, but I think there is definitely a resurgence of that that we are seeing today.

Mr. RUE. I think, Mr. Chairman, that that problem exists in the certain lines where there are serious problems, that is, municipal liability, pollution, day care to some extent. But I know in my own office I am seeing a great deal more of risk reductions and concentrating on ways various businesses can reduce potential insurance losses, and frankly I have found a good response from many of our carriers.

I would also like to comment just briefly about the question you asked earlier about the exemption under antitrust.

One of the things that I have found in my office, and I know many agents across the country have found, that the salvation to them in this type market and to their clients have been the smaller regional companies that do not do business throughout the United States. These are the companies that benefit most from the exemption under antitrust. They are not large enough to gather enough statistics to form a viable opinion underwriting on the amount of money that should be charged for a risk, so they use the basis of the statistics of the industry as a whole to base their pricing.

Mr. FLORIO. Is there any validity to the argument that has been raised by some that when ISO, for example, submits the rate in the automobile industry in New Jersey, it is a rate that is in a sense averaged out for everyone off of their experience, and that the averaging-out process is protecting the less competitive producers who in a marketplace model would be shaken out, so that you would have reinforcement for the more productive insurance companies to provide better rates, but for the averaging process that comes as a result of antitrust protection?

Mr. RUE. Well, they do in fact provide an advisory rate, but in periods of competition, when the industry is in a healthy position, it is not usually the ISO rates that are followed, it is normally a deviation from that.

Mr. FLORIO. In the automobile insurance industry we have not seen a whole lot of competition, at least in my State.

Mr. RUE. That is certainly true in New Jersey.

Mr. BAILEY. In automobile insurance rates?

Mr. FLORIO. Yes.

Mr. BAILEY. That has not been the case in Texas. Now there are some changes being made, but I think some of the States you have seen a lot of competition. We have been in a process for the last several years of deviating from the State rates by 10, 15, 20, 25 percent.

Mr. FLORIO. But that is competition in coverage, isn't it?

Mr. BAILEY. No.

Mr. FLORIO. Certainly you can get better rates if you don't have as extensive coverage.

Mr. BAILEY. No, I am talking about coverage rates. We have seen extensive competition. Now the companies are underwriting in a much stricter fashion.

Today we can offer, say, a 15 percent deviation on a personal liens automobile out of our office, but the standards of underwriting that apply may say that no member of that household can have had a speeding ticket. In other words, it is very strict underwriting, but we are still offering those type competitive rates. We are doing it every day.

Mr. FLORIO. Is that underwriting directed towards individual performance records?

Mr. BAILEY. Individual performance records, yes.

Mr. FLORIO. I might call you back if we take up unisex insurance coverage, because that was one of the arguments that some made as to justifying that type of——

Mr. BAILEY. I will never refrain from discussing sex.

Mr. RUE. Even in your state, Mr. Chairman, there are some companies that are deviating from ISO rates.

Mr. FLORIO. Let me express my appreciation for this very informative panel's participation here today. Thank you very much.

We are now pleased to have as our last witness a distinguished Member of the Congress who has taken a very active role in attempting to address the problem which is the subject of this hearing, the Honorable John Porter.

We welcome our colleague to the committee. His statement will be made a part of the record in its entirety. He may proceed as he sees fit.

STATEMENT OF HON. JOHN E. PORTER, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF ILLINOIS

Mr. PORTER. Mr. Chairman, thank you for allowing me to testify this morning. Let me commend you for holding these hearings on a subject that I think is of terribly great importance to our country.

I too have a written statement for the record. I would prefer that we simply leave that there, and let me talk with you for a minute or two about some of the things that I have seen happening and some suggestions I have for you to consider.

First, some of the horror stories. Mr. Chairman, I have a park district that is going to pay 50 times more for liability insurance this year than just 3 years ago. In fact, the amount that they are going to pay in terms of a premium for this year is five times higher than the total amount of claims that they have ever had during the entire time the park district has been in existence.

I have got paramedics in one of my small towns that can't get any coverage at any cost. They are worried about not providing the coverage because they are going to be sued for not having paramedics. They are in a catch-22.

I have a high school in Winnetka, one of the preeminent public institutions at the secondary level. We were going to, until 3 days ago, shut down their entire athletic program because they couldn't get any coverage.

I have many towns, one of them called Northbrook. They have a sledding and toboggan hill. They have got to shut it down because they can't get coverage.

I have got a town, Highland Park, with a 387 percent increase in their premium for this year. 387 percent. Their taxes are going to have to go up a lot to pay for it.

We have companies that can't put their products on the market because of the cost of product liability coverage and still sell them at a profit.

We have got production of essential vaccines, as you know, that protect our children. We can't get them out on the market because there is no liability insurance available.

It seems to me that this is a crisis that once was a medical malpractice crisis, once was a product liability crisis. Now it has reached the stage where it reaches every school district, every municipality, every park district, every township, every fire protection district, and all the rest, and it reaches people directly and individually and hits them in the pocket books, and it is time that we did something about it.

It is a problem that ought to be solved and addressed at the State level because the solution lies, I think, not in changing our insurance coverages or regulating insurance companies, but rather in addressing problems of the tort system itself.

The tort system itself has been traditionally under State control primarily and it is there where the issue ought to be addressed.

A recent suggestion was that we have some form of Federal reinsurance. Let me say, Mr. Chairman, that that is the worst idea I have heard in a long time. Obviously, all that does is to push the problem to a different level, to use different resources to pay the same costs, and never address the real problem itself at all. That strikes me as continuing what we have in place, and that is a tort system that has become a comprehensive social insurance plan rather than simply the attempt to right wrongs that are the fault of one person as opposed to another.

I think that what we have to do at this point in time is to urge the States to act. I think we need to threaten and maybe actually to put into place some sticks that would force comprehensive changes in the tort systems at the State level.

Two elements of those changes it seems to me are absolutely important, absolutely essential. One is to put a cap on noneconomic loss recoveries. Two States, California and Indiana, have done that to good effect. I think without that you are talking about an insurance situation that simply can't be rated and the problem will continue.

The second is to urge States to do away with the doctrine of joint and several liability, at least for those responsible for less than half of the fault in any case.

A third one also essential, I think, is to shorten up statute of limitations and discovery periods.

These are matters within the purview of the States, obviously, but I think the Federal Government can say, "Look, this problem, while it isn't a Federal problem in the overall sense, is a national problem, and there are today and will be in the future, unless something is done, demands for national solutions. We will have to go to that point unless you are willing to act and act quickly and act decisively."

My own State of Illinois last year passed a plan that included requiring insurance companies to keep coverages in place, and holding down the rates of increase. That is not a solution to the problem; that is simply putting a band-aid in place and shifting it to other people. So it seems to me that those kinds of solutions that some of the States are offering are not the way to get at the main problem.

The way to get at it is very clear. It has to be a solution designed to change how the system works, and how the recoveries are made and to put some element of fairness and predictability into it.

If you look more broadly, surely we ought to facilitate removing from the medical profession those people who are not competent and who are not providing services at a professional level.

I heard, Mr. Chairman, recently of a suit that was brought against a peer review committee by a doctor under the Antitrust Act, saying that their judgment of his medical capabilities, which would force him out of practicing at that particular hospital, was obviously designed to stifle competition in providing health care services. As ridiculous as that sounds, I wouldn't doubt that some judge somewhere might decide that that is in fact true.

We ought to give to those in the peer review process antitrust immunity, and maybe even antidiscrimination immunity, so that those kinds of suits can't be brought, and so that pressures can be brought to bear on the providers who are not competent, and who push up the rates of insurance to cover themselves.

I think at this point, Mr. Chairman, that what we in Washington ought to do is to look at what kind of pressure we can bring on States to actually address the problem, to do those things that are necessary to make the insurance coverage rateable, to make the system fair, so that it operates in an equitable way for all claimants upon it. Only in that way do I think we are really going to get a solution to the problem.

I appreciate the opportunity to testify.

Mr. FLORIO. Thank you very much.

[The statement of Mr. Porter follows:]

TESTIMONY OF

CONGRESSMAN JOHN E. PORTER

Mr. Chairman, today we in Congress are being sought out at every turn by people at home who are shocked and bewildered by the sudden high cost or complete lack of liability insurance. This crisis touches every business, every professional person, every local government official, every consumer, every taxpayer.

I can cite innumerable examples from my district. The Northfield, Illinois Park District will pay fifty times more for liability insurance this year than in 1983. The annual premium quoted for 1986, $20,000, is five times higher than the total amount of claims in the history of the park district. Doctors are retiring early from high-risk specialities; the jobs and new products of small manufacturers are being lost to overseas competitors because it is impossible for them to get product liability coverage and still operate at a profit; school sports programs are dropped; production of essential vaccines to protect our children against polio and DPT lapses because no liability insurance is available. Small businesses like pest control companies are trapped in the Catch-22 of being required to carry insurance to be licensed but being unable to find or afford insurance and prohibited from forming self-insured risk pools.

These are just a few instances, but they highlight the negative side of the "liability explosion". When exterminators cannot get coverage, then we have rats, roaches and disease. When schools

cannot offer sports programs and municipalities cannot run emergency rescue vehicles, then our youth and elderly will suffer. When our businesses cannot make a profit, then jobs will disappear. When local governments face outrageous suits, the taxpayer picks up the bill. The mounting national catalog of horror stories and unfortunate consequences of the liability explosion is just mind-boggling.

Disbelief, outrage, despair are natural reactions for those whose actions and livelihoods are jeopardized. We in Congress are terribly concerned, but we must also guard against misdiagnosing the problems and misprescribing the solutions. The problems and the solutions for the liability crisis, like the elephant described by the six blind men, take on a different character when viewed from the perspective of product liability, or environmental liability, or professional liability, or local government liability.

The very best role for the Congress at this point is to help state governments and our constituents look beyond their outrage, despair, and paralysis to find concrete solutions. This is why I applaud your subcommittee's interest in holding hearings on this issue.

I would like to make some suggestions about where I think these solutions will be found and who should find them.

As one who served in the state legislature in Illinois for a number of years before coming to Congress, I strongly believe that most of these liability issues can best be addressed at the state level. Some states have already taken action to get liability problems under control. In other states, the conflicts between people with a vested interest in promoting ever-wider definitions of actions subject to litigation and those who seek to reestablish some balance has led to paralysis and inaction. This is the case even in areas like medical malpractice where ten years of experience with the liability crisis have made it clearer and clearer what needs to be done.

It is time for us all to face a few fundamental facts. First, the tort system is not a comprehensive social insurance plan. Not all wrongs can be righted through the tort system, and certainly not by dragging "deep pocket" defendants with minimal fault into suits in hopes of large settlements under a joint and several liability standard. Comparative fault must be reestablished as the standard to judge the financial liability of minor parties in tort suits.

Second, there must be some reasonable cap, say $250,000, placed on awards for non-economic losses. As the shuttle tragedy so clearly brought home to all of us, pain and suffering are very real. When something unfortunate strikes us or a loved one, there is not enough

money in the entire world to ease the pain. Judges and juries know this, too. Some therefore decline to give any award for pain and suffering; others value it at an arbitrary level, sometimes upwards of a million dollars.

Without a cap, however, and without a reasonable relationship between culpability and financial liability, we will soon be living in a world without insurance and full of bankruptcy and taxpayer revolts.

Insurance can only exist where risks are relatively predictable and can be spread. That is not the case today. Insurance is an extremely complicated product, one whose price must reflect actuarial calculations of risk. The capitalization, pricing, and management of insurance must be monitored carefully and conscientiously by the state so that consumer interests are protected. We need better insurance, not less insurance or a pie-in-the-sky illusion that the federal government can somehow pay the tab for all the risks that no one else is able to cover.

Caps and the restoration of a comparative negligence standard are the two most essential elements in insuring that, in the future, harmed parties will be able to be compensated. If we keep going with a redistribution approach which seeks compensation for harmed parties without regard for negligence or cost, we will stifle the tort system and wipe out the best means we have for allowing calculated risks to be taken that will lead to a better and safer world.

State governments that have not yet acted must face up to their responsibilities to make these changes and others that will over time restore balance to the civil justice system. In areas where they cannot or will not take action, it is likely that the federal government will eventually have to intervene to insure that this growing crisis does not continue.

Mr. FLORIO. Let me just make a couple of observations. You have suggested that ultimately someone will start advocating national tort reform, and of course some are already starting to talk about that.

Mr. PORTER. Sure.

Mr. FLORIO. Your suggestion is that the States undertake to make the revisions, the types of revisions you have stated.

I think as a practical matter we are seeing the States go almost in the opposite direction. The States are taking more expansionist interpretations of laws. I think in some respects, some have made the argument that that is a result of the breakdown in the traditional regulatory risk abatement mechanisms.

In the area of the environment, I am familiar with a court decision that interpreted the Superfund law to arrive for a right for municipalities to have the authority that I think we provided to the State agencies and to the Federal agencies to enforce the law. I think that interpretation flowed from a perception by the court that the agencies that were clearly designated agencies to take the action, the Federal agency, EPA, and the State agency that could have those responsibilities delegated to it, were not doing anything sufficient to remedy the problem. Therefore, the court felt the latitude to interpret the law so as to give to a subdivision of the State, namely a town, the authority to enforce the law.

I think also that came from a perception by the court. I think this is a characteristic of the court system, that the court doesn't feel comfortable leaving citizens or communities with no remedy to deal with a wrong.

Mr. PORTER. Exactly.

Mr. FLORIO. So that the State level courts are taking on burdens for which they may not be equipped, but they are doing it because there is this great void in the law.

The executive agencies, the regulatory agencies, the Congress and other legislative bodies don't appear to be addressing the serious problems that are arising. Therefore, the court steps into the breach, and I say, you may lament that, but unless you are prepared to somehow induce the regulatory agencies to deal with safety questions, health questions, environmental questions that are undoubtedly causing serious problems out there, we are going to be left with that, and we are going to be left with this development at the State level.

Mr. PORTER. I certainly wouldn't disagree with what you are saying. It is clear that the courts feel it their responsibility to allow no one who has been in fact injured and come before them to leave without some kind of protection or some kind of remedy.

We have gotten virtually strict liability with respect to products in the marketplace, and yet there seems to be nothing in place in this system at all, not only to put a brake on it so it is predictable, but to make it equitable either.

This is the same kind of situation out of which workers' compensation arose 75 or 80 years ago, and perhaps—and I don't suggest it—but perhaps there is a need for some kind of a complete change in our entire tort recovery system that would make the whole system more fair, more equitable, and certain.

I don't suggest that because I think that it has been in the purview of the States to design those kinds of systems, but this one, the one presently, for whatever reason, and the reasons you cite are certainly valid ones, is out of hand. It is out of hand.

The worst thing about it is not that we are spreading costs, because that is what insurance is designed to do; the worst thing about it is that we are having insurance companies that have previously been in there attempting to provide the protection and make a profit, as they should, saying, "I don't want anything more to do with this," and we are having people that can't even get coverage now at any cost.

That strikes me as a total breakdown of the system, and indicates that there are problems beyond regulation of insurance companies, beyond controlling lawyers' fees, problems with the system itself that must be addressed if we are going to solve the problem.

Mr. FLORIO. Let me express my appreciation to you.

Mr. PORTER. Thank you very much, Mr. Chairman.

Mr. FLORIO. If there is no further business to come before the committee, the committee stands adjourned.

[Whereupon, at 12:40 p.m., the subcommittee adjourned to reconvene at the call of the Chair.]

LIABILITY INSURANCE AVAILABILITY

THURSDAY, FEBRUARY 20, 1986

HOUSE OF REPRESENTATIVES,
COMMITTEE ON ENERGY AND COMMERCE,
SUBCOMMITTEE ON COMMERCE,
TRANSPORTATION, AND TOURISM,
Washington, DC.

The subcommittee met, pursuant to notice, at 9:33 a.m., in room 2322, Rayburn House Office Building, Hon. James J. Florio (chairman) presiding.

Mr. FLORIO. The subcommittee will kindly come to order. Mr. Lent is on his way, so we are going to start, and he should join with us momentarily.

I want to welcome all in attendance to our third in a series of hearings that we are conducting with regard to the questions about the unaffordability or the unavailability of liability insurance. We are hopeful that we will have a few more hearings before we determine what action, if any, we will be taking.

It is my hope that we will be in a position to hear from insurance industry representatives directly in our next hearing. And then the question that we will explore in some depth is dealing with the whole series of proposals that have been offered concerning alternatives to traditional insurance.

We are hopeful that today's hearing can be of some assistance to us as we try to understand a bit about the current regulatory system from those who are most qualified to provide us with that information—people, for the most part, who are at the State level, particularly in the area of State regulation.

The insurance capacity crisis has spread from medical malpractice and products liability to scores of other areas, including day care centers, officer and director liability, and general liability coverage for small businesses, as well as municipal and county insurance coverage.

In our earlier hearings, various causes for the present crisis were suggested. Questions were raised, for example, about our civil justice system, about the financial practices of insurance companies, and about the adequacy of the enforcement of laws protecting the public from health and safety hazards, in other words, risk abatement.

Today we are going to concentrate mainly on the perspectives of our States in their current responsibilities for regulating insurance. The views of our State officials are greatly valued by this subcommittee. Forty years ago Congress made clear the primary responsibility of the States for the regulation of insurance. While Congress

also said it would periodically review this mandate, history dictates that we look to the States first for the response to the present difficulties.

I think I can speak for everyone on the subcommittee when I say that we approach this issue with an open mind.

It should not be assumed that because a congressional committee is investigating this issue that Federal action is the solution. I do not believe that simply substituting Federal regulation for State regulation will improve the situation, especially given the rather sad performance recently of most Federal agencies in enforcing the laws that they are charged with enforcing, that there is no dispute about.

On the other hand, just because we have always done something in a particular way does not necessarily make it appropriate that it be conducted in that same way for all time. Reassessment is called for, especially when we are facing, as we are, very different economic conditions before us. Therefore, the main purpose of these hearings is to become involved in that process of understanding and that process of reassessment.

So we are here today to continue that process. The one thing we cannot do is to ignore the growing threat to businesses, particularly small businesses, professionals municipalities, nonprofit corporations, and others that is resulting from the insurance crisis.

We have had some testimony, and I have seen comments, that the problem is almost over—that we now have everything in place such that all we have to do is wait it out and wait it through. Unfortunately, if that process is what we do, there will be a lot of people who will not be around at the end of the process as we patiently wait it through.

I am very grateful to the distinguished and expert group of witnesses that we are going to hear from today, to provide us with their thoughts on this very important subject.

I am now pleased to present the distinguished member from New York, our ranking minority member, Mr. Lent.

Mr. LENT. Thank you, Mr. Chairman. I would first of all, like to commend you for continuing this series of hearings. This hearing should prove to be very helpful in our continued effort to understand the causes of the problems within the property/casualty insurance market.

The insurance commissioners and the State legislators are, of course, the regulators of the insurance industry. I look forward to hearing what they believe is causing the current affordability and availability problems in the industry; what methods are being used to remedy the problems; and if those methods are producing positive results.

A representative of the Risk and Insurance Management Society will also be testifying today. I will be interested to hear if corporations are encountering the same difficulties in obtaining liability insurance as some of the small business persons, municipalities and professionals who have testified before the subcommittee previously.

I appreciate the appearance of all our witnesses today, and I am sure your testimony will prove informative.

Thank you, Mr. Chairman.

Mr. FLORIO. Thank you very much.

We are now pleased to have as our first witness. Hon. Edward Zuccaro, representing the National Conference of State Legislatures. Mr. Zuccaro.

STATEMENT OF EDWARD R. ZUCCARO, VICE CHAIRMAN, LAW AND JUSTICE COMMITTEE, NATIONAL CONFERENCE OF STATE LEGISLATURES

Mr. ZUCCARO. Mr. Chairman, Mr. Lent, I am Edward Zuccaro, member of the Vermont House of Representatives. I am very pleased to be here today to be able to share with you some of the views of the National Conference of State Legislatures on this issue of availability and affordability of insurance, and the entire issue of liability insurance as viewed by the States.

The entire question of liability insurance ranks virtually at the top of the agenda of, I think, most every State legislature that is in session. And all of the States are in session, with the exception of seven. Those seven that are not in session have various study committees that are meeting while they are out of session reviewing this important topic.

There have been some 1,200 separate pieces of legislation that have been introduced up to this point. I understand that the State of New York legislature is presently about to conclude a lengthy study with regard to this topic, and it has been suggested that once they have completed that, the New York Assembly is likely to see that number of 1,200 raised to perhaps 1,500 or so, pieces of legislation dealing with this topic.

So it is clearly the hot topic of the year as far as State legislators go. The legislatures are responding. There have been comprehensive interim study reports, task forces, commissions, and special study groups.

NCSL has made tort reform and liability insurance one of its top priorities. It has conducted a number of studies and surveys, copies of which have been made available to this committee already.

There were three additional reports that are currently in the works, one dealing with Federal jurisdiction in the area of liability insurance, one dealing with regulatory intervention, and one dealing with risk management practices. These reports and studies will be available for the committee within the next month or two.

In addition, NCSL has conducted a number of nationwide seminars and public meetings on this topic, which has attracted participation from State legislators in virtually every State and members of the industry.

The problems are many and varied. They affect both, as the chairman indicated, the private sector and the public sector. The problems deal with unavailability of certain lines, unaffordable premiums, and in Vermont in particular, the area of municipal liability and dram shop has been a significant problem.

With regard to municipal liability, I would share with the committee the experience of one very small village, the village of Richmond, VT. Vermont, as I am sure you are well aware, has very few large municipalities. There are mostly small villages and towns,

with very, very small budgets, who are run by groups of volunteers for little or no payment.

The village of Richmond was informed that they would not be renewed for the selectmen's or village trustees' liability insurance. And it got to the point that they were unable to replace that coverage. And at one point the entire board was prepared to resign, rather than serve without insurance, and run exposed.

Ultimately, they were successful in obtaining coverage through other sources, but that is a real and serious problem faced by local governments.

Local governments, I think, have a unique problem in that they are viewed, to some extent, as being the deep pocket. In those States that have a theory of recovering for joint and several liability, if there is a municipal defendant, that is where the recovery is going to come from. This is worsening a problem that is already a serious and difficult problem.

Another problem area relates to State regulatory practices. The chairman indicated in his opening remarks, the States have, I think, to review the adequacy of their regulatory practices and standards, to ensure that they are adequate to meet the needs and the problems that are being raised by the current crisis.

Court decisions are also problemmatic. The area of sovereign immunity has been whittled away by the courts so that in many States it no longer affords the protection it once did, and in many States, is nonexistent.

The Vermont Supreme Court recently issued a decision which I think will have, in the long term, serious implications, in that the court has held that the host of a private party was liable for a guest who became intoxicated at that party, who was later involved in an automobile accident. There has already been discussion within the legislature to consider legislation that would respond to that court decision.

The causes of the problem with regard to liability insurance, I think, are as many and varied as the problems. In the various studies that NCSL has conducted and prepared, I do not think that they have come anywhere near pinpointing any particular causes as being more significant than others. I think it varies tremendously from State to State and region to region as to what causes are more significant than the others.

The States, I think, are responding to these problems and looking at the causes in an attempt to deal effectively with the problem. As I indicated earlier, some 1,200 bills have already been introduced. The initiative is not only coming from legislative response, but is also coming in part through the regulatory process.

New Jersey, I am told, has implemented through its regulatory process, a prohibition on midterm cancelations. Nine States permit the establishment of insurance pools. Some 14 States, including Vermont, have implemented market assistance plans to ensure availability.

West Virginia is considering establishing comprehensive self-insurance funds. New York State is contemplating a 60-day mandatory notice for nonrenewals of premiums, and similar legislation has recently passed in Washington State.

The State response has not been entirely with regard to insurance, the insurance industry. Some of the response has been in the area of proposals for tort reform.

Michigan has passed legislation capping awards for medical malpractice. Connecticut is looking at limiting lawyer's fees and capping awards and judgments for pain and suffering.

I understand that New York may be considering legislation to limit joint and several liability where there is a municipal defendant. Four States have installed centralized risk management systems.

In California, legislation has recently been upheld restricting attorney's contingency fees, and that's somewhat of a mixed bag. I understand that in Illinois, similar legislation has been held to be invalid.

In Vermont, we have taken steps to give the commissioner of insurance authority to mandate the establishment of a joint underwriting association when he determines that—particular insurance lines are unavailable or are available at a cost which is prohibitive.

We are also considering in Vermont, bills which would cap attorney's fees, and would limit noneconomic damages. In addition, we are considering a proposal which would give a good faith immunity to local officials when acting in their official capacity.

Because the problems and the causes and the responses by the State have been so varied, I would say that the National Conference of State Legislatures is not coming before you this morning endorsing any one of these as a particular remedy that we think should be looked at.

The various States have different problems that have to be addressed, and we think that the States are, in fact, taking the steps necessary to address these problems. Some of them are short term remedies. Others are long term remedies.

In addition to the State response, I think this committee has got to consider, and is interested in considering what the appropriate Federal role should be. First, it is the NCSL position, and has been taken by NCSL at a general meeting and adopted as part of their policy, to permit the States to continue moving forward to deal with this issue.

The potential role of the Federal Government, however, is to continue its efforts with regard to the areas that it is presently involved in. That is, in the area of environmental liability insurance, truckers' coverage, the Price-Anderson Act. And we would urge, in addition, continued cooperation with NCSL, other agencies representing State and local governments, and the State and local governments themselves.

We would suggest that it is appropriate, if it becomes evident that the State and local initiatives are not adequate and are not working, at that point, for the Federal Government to reexamine its position and determine what steps would be appropriate at that point. However, at this point, I would suggest that that would be premature.

We would recommend and suggest that this committee continue to hold hearings, to provide a forum for organizations such as NCSL, for the States, for the insurance industry, and for the consumers, to have an opportunity to bring before you what we per-

ceive to be the problems, and the responses that are being made, and to share with you whether they are, in effect, being successful.

Mr. Chairman, I appreciate very much the opportunity to appear before the committee and to share with you the position of the National Conference of State Legislatures on this issue.

[Testimony resumes on p. 527].

[The prepared statement of Mr. Zuccaro and attachments follow:]

STATEMENT BY

REPRESENTATIVE EDWARD R. ZUCCARO

ON BEHALF OF

THE NATIONAL CONFERENCE OF STATE LEGISLATURES

I AM STATE REPRESENTATIVE EDWARD R. ZUCCARO OF SAINT JOHNSBURY, VERMONT. I APPEAR BEFORE YOU TODAY AS A REPRESENTATIVE OF THE NATIONAL CONFERENCE OF STATE LEGISLATURES. I SERVE AS A VICE-CHAIR OF NCSL'S LAW AND JUSTICE COMMITTEE.

THE NATIONAL CONFERENCE OF STATE LEGISLATURES (NCSL) IS THE OFFICIAL REPRESENTATIVE OF THE NATION'S 7,461 STATE LAWMAKERS. THE ORGANIZATION PROVIDES BASIC ISSUE RESEARCH, TECHNICAL ASSISTANCE, COMPREHENSIVE FEDERAL BUDGET AND FUNDING DATA AND TRAINING SERVICES FOR LEGISLATORS AND THEIR STAFFS. SINCE ITS CREATION IN 1975, THE ORGANIZATION HAS ALSO SERVED AS THE WASHINGTON, D.C. LIAISON FOR ALL STATE LEGISLATURES AND HAS PROMOTED POLICIES DEVELOPED THROUGH A STATE-FEDERAL ASSEMBLY.

I APPRECIATE THIS OPPORTUNITY TO SHARE WITH YOU NCSL'S CONCERNS REGARDING THE AFFORDABILITY AND AVAILABILITY OF LIABILITY INSURANCE. THIS ISSUE RANKS AT THE TOP OF VIRTUALLY EVERY STATE LEGISLATURE'S AGENDA IN 1986. EVEN AMONG THE SEVEN STATES NOT IN SESSION, INTERIM STUDY GROUPS AND POSSIBLY SPECIAL SESSION CALLS (IN MONTANA AND NORTH CAROLINA, FOR EXAMPLE) ARE OCCUPIED PRIMARILY WITH THE CAPACITY CRISIS.

OVER 1,200 PIECES OF LEGISLATION HAVE ALREADY BEEN INTRODUCED POSING A WIDE ARRAY OF POTENTIAL REMEDIES. THEY HAVE BEEN ACCOMPANIED BY UNCOUNTED REGULATORY INITIATIVES. IT CERTAINLY IS PREMATURE TO SAY, WITH ANY DEGREE OF ACCURACY, JUST WHAT LEGISLATION WILL PASS OR WHAT WILL WORK EFFECTIVELY TO PROVIDE SHORT-AND LONG-TERM RELIEF REGARDING PRICE AND AVAILABILITY OF VARIOUS LINES OF [illegible]ILITY COVERAGE.

WHAT IS OBVIOUS IS THAT LEGISLATORS ARE RESPONDING EXPEDITIOUSLY TO A CRISIS WHICH HAS EMERGED RAPIDLY. MANY STATES, INCLUDING MARYLAND, WASHINGTON, COLORADO AND MICHIGAN HAVE COMPLETED COMPREHENSIVE INTERIM STUDY REPORTS. SEVERAL OTHERS, INCLUDING ILLINOIS, NEW YORK, ARIZONA AND TEXAS, CURRENTLY HAVE TASK FORCES, COMMISSIONS OR SPECIAL STUDY GROUPS SURVEYING THE EXTENT OF THE PROBLEM AND WEIGHING THE POTENTIAL IMPACT OF PROPOSED SOLUTIONS. NCSL HAS MADE LIABILITY INSURANCE ONE OF ITS TOP PRIORITIES AND HAS COMPLETED SEVERAL PUBLICATIONS (SOME OF WHICH HAVE BEEN PREVIOUSLY SHARED WITH THIS SUBCOMMITTEE'S MEMBERSHIP) AND HELD SEVERAL NATIONWIDE SEMINARS AND PUBLIC MEETINGS ON THE SUBJECT.

PROBLEMS

THE PROBLEMS WHICH STATE LEGISLATORS FACE REGARDING THIS ISSUE ARE MULTIPLE. IN FACT, IT IS THE BOARD COMPOSITE OF PROBLEMS COMING TOGETHER SIMULTANEOUSLY WHICH APPEARS TO MAKE THIS CRISIS MORE SEVERE THAN PRIOR ONES. BOTH PUBLIC AND PRIVATE SECTOR ENTITIES HAVE BEEN HIT HARD WITH MID-TERM CANCELLATIONS AND NONRENEWALS. UNAVAILABILITY OF CERTAIN LINES HAS SURFACED. UNAVAILABILITY HAS BEEN EXACERBATED BY UNAFFORDABLE PREMIUMS. FAILURE TO OBTAIN INSURANCE HAS RESULTED IN NON-LICENSURE OR NON-CERTIFICATION TO CONDUCT BUSINESS. REINSURANCE HAS ALSO DONE A DISAPPEARING ACT OF ITS OWN. IN VERMONT, MUNICIPAL LIABILITY AND DRAM SHOP INSURANCE HAVE EMERGED AS OUR MOST SEVERE COVERAGE PROBLEM AREAS.

INCREASED LITIGIOUSNESS AND GREATER TOTAL DOLLAR CLAIMS PAYMENTS HAVE SOMEWHAT COMPROMISED PREDICTABILITY WITHIN AN INDUSTRY WHERE PREDICTABILITY HAS

USUALLY BEEN DIFFICULT TO GAUGE. MIX THIS WITH THE NEED TO PROVIDE REASONABLE COMPENSATION TO INJURED PARTIES, ENSURE DUE PROCESS AND EQUAL PROTECTION OF THE LAW AND YOU HAVE A MAJOR CHALLENGE.

STATE AND LOCAL GOVERNMENTS ARE EXTREMELY EXPOSED. GOVERNMENT ACTIVITIES ARE TERRIBLY BROAD. A RECENT PENNSYLVANIA HOUSE OF REPRESENTATIVES REPORT CONCLUDES "...INSURANCE MARKET ECONOMICS AND DYNAMICS APPEAR TO BE ILL-SUITED TO DEAL WITH THE SPECIAL SOCIAL AND POLITICAL STATUS OF MUNICIPAL NTITIES". THE FINANCIAL STATUS OF STATE AND LOCAL GOVERNMENTS IS GENERALLY PERCEIVED TO BE HEALTHY. THEY MAY NOT HAVE THE RESOURCES TO BE ENTANGLED IN LENGTHY DISCOVERY AND SUBSEQUENT COURT BATTLES AND, THUS, ARE POTENTIALLY MORE INCLINED TO SETTLE. ALSO, STATE AND LOCAL GOVERNMENTS HAVE BECOME A MORE ATTRACTIVE TARGET WITH THE LOSS OF SOVEREIGN IMMUNITY. ONLY 7 STATES RETAIN FULL PROTECTION TODAY (ALABAMA, ARKANSAS, DELAWARE, KENTUCKY, NORTH DAKOTA, VIRGINIA AND WEST VIRGINIA). TOTAL IMMUNITY FOR MUNICIPALITIES EXISTS IN BUT 4 STATES (ARKANSAS, DELAWARE, OHIO AND VIRGINIA).

STATE REGULATORY PRACTICES AND RESOURCES HAVE COME INTO QUESTION. CONTROL OVER RATE-SETTING AND EFFECTIVE OVERSIGHT OF INSURERS APPEARS TO RUN THE ENTIRE QUALITY GAMUT. TO WHAT EXTENT REGULATORS ALONE COULD HAVE PREVENTED OR TEMPERED THIS CRISIS IS A MATTER WHICH VIRTUALLY EVERY STATE IS ADDRESSING.

THESE ARE MERELY EXAMPLES OF A MYRIAD OF PROBLEMS WHICH THE FIFTY STATES, TO VARYING DEGRESS, ARE CONFRONTED.

COURT DECISIONS ARE ALSO PROBLEMMATIC. RECENTLY, VERMONT'S SUPREME COURT RULED THAT HOSTS OF A PRIVATE PARTY WERE RESPONSIBLE FOR THE POST-PARTY ACTIONS

OF AN INDIVIDUAL WHO BECAME INTOXICATED DURING THE FESTIVITIES. LEGAL DE [illegible]IONS ARE NEVER PREDICTABLE BUT THEY DO SIGNIFICANTLY AFFECT THIS PARTICULAR ISSUES.

CAUSES

THIS SUBCOMMITTEE HAS ALREADY HEARD, IN PRIOR MEETINGS, OF THE NUMEROUS CAUSES FOR THE CRISIS. JUDGING FROM MY OWN EXPERIENCE IN VERMONT AND FROM INFORMATION OBTAINED BY NCSL, THE CAUSES OF THE CRISIS ARE MANY. CASH FLOW UNDERWRITING AND INADEQUATE PREMIUM INCOME, REGULATORY SHORTCOMINGS, RISING DOLLAR LOSSES FROM INCREASED JUDICIAL SETTLEMENTS, DISAPPEARING REINSURANCE, SUBSTANDARD RISK MANAGEMENT ANALYSIS AND SKYROCKETING PREMIUM INCREASES ARE AMONG THE FACTORS CONTRIBUTING TO THE CURRENT DIFFICULTIES. NEITHER NCSL NOR I HAVE YET TO COME ACROSS THE ANALYSIS WHICH CAN EASILY AND CONVINCINGLY DECIPHER WHICH FACTOR HAS CAUSED WHAT PROPORTIONATE AMOUNT OF THE PROBLEM. WHETHER THAT REPORT CAN OR WILL BE WRITTEN, I AM BOTHERED THAT GOVERNMENT AND BUSINESS ARE THREATENED WITH LOSS OF INSURANCE. THEY ARE, IN SOME INSTANCES, UTILIZING MORE OF ALREADY LIMITED RESOURCES TO REMAIN INSURED WHILE CUTTING OPERATIONS. DISAPPEARANCE OF PARTICULAR LINES OF COVERAGE, POLLUTION LIABILITY IN GENERAL AND MORE SELECTIVE LIENS DEPENDENT ON WHICH STATE WE ARE DISCUSSING, IS A SERIOUS MATTER.

AMONG THE FIFTY STATES, SEVERAL ADDITIONAL CAUSES HAVE SURFACED AND MERIT YOUR ATTENTION:

- INCREASED PREMIUIMS REGARDLESS OF CLAIMS HISTORY.
- LOSS OR RESTRICTION OF SOVEREIGN IMMUNITY.
- DEFICIENT SAFETY PRACTICES RESULTING IN UNNECESSARY INJURY

- UNPREDICTABLE INDUSTRY BEHAVIOR.
- UNCERTAINTY REGARDING NUMBER AND SIZE OF FUTURE CLAIMS AND LOSSES RESPECTIVELY.
- DECLINE IN RETURN ON INSURANCE INDUSTRY INVESTMENTS.
- UNDERCAPITALIZATION OF NEW ENTRANTS.
- COSTLY ADMINISTRATIVE COSTS REGARDING TORT LIABILITY CASES.
- FEAR OF UNMEASURABLE LIABILITY.
- JOINT AND SEVERAL LIABILITY.

SEVERAL STATEMENTS MUST BE MADE ABOUT THESE CAUSES. THEY ARE NOT COMPREHENSIVE. SOME OF THEM ARE NOT OF RECENT VINTAGE. THEY ARE NOT IN PRIORITY ORDER. STATE LEGISLATORS HAVE DIVERSE OPINIONS ABOUT WHICH OF THESE CAUSES ARE THE PRIMARY PRECIPITATORS OF CURRENT PROBLEMS. LINKAGES BETWEEN THESE CAUSES AND SOLUTIONS BEING POSED ARE DIFFICULT TO VERIFY. STATES WITH CERTAIN ACCLAIMED REFORMS ARE SEEING THEIR BUSINESSES AND SERVICE PROVIDERS HIT WITH THE SAME UNAVAILABILITY AND PRICE PROBLEMS AS THOSE WITHOUT.

STATE ACTION

STATES HAVE TAKEN ON THE CHALLENGE OF THE CURRENT AFFORDABILITY AND AVAILABILITY CRISIS, BOTH IN PAST LEGISLATIVE SESSIONS AND IN CURRENT DELIBERATIONS, AS THE FOLLOWING EXAMPLES AND INFORMATION INDICATE:

- AS I MENTIONED EARLIER, OVER 1,200 BILLS HAVE BEEN INTRODUCED THIS YEAR ON THIS SUBJECT. THAT REPRESENTS ONE BILL FOR EVERY FIFTH LEGISLATOR IN SESSION. THAT COUNT RISES DAILY. AN NCSL REPORT ON THESE BILLS IS FORTHCOMING. NCSL WILL ALSO MONITOR EACH STATE'S BILL PROGRESS. I WILL SEE THAT THIS

SUBCOMMITTEE RECEIVES ALL REPORTS EXPLAINING LEGISLATIVE DEVELOPMENTS ON THIS TOPIC IN THE STATES.

o NEW JERSEY IMPLEMENTED, BY REGULATORY INITIATIVE, PROHIBITIONS ON MIDTERM CANCELLATIONS.

o AT LEAST NINE STATES (ARKANSAS, FLORIDA, ILLINOIS, LOUISIANA, MICHIGAN, MINNESOTA, OHIO, TENNESSEE AND TEXAS) PERMIT ESTABLISHMENT OF INSURANCE POOLS FOR GOVERNMENTS.

o NO LESS THAN 14 STATES (ARIZONA, CONNECTICUT, GEORGIA, ILLINOIS, KANSAS, MAINE, NEW MEXICO, MARYLAND, MISSISSIPPI, NEW HAMPSHIRE, SOUTH CAROLINA, VERMONT, VIRGINIA AND APPARENTLY TEXAS) HAVE IMPLEMENTED MARKET ASSISTANCE PLANS TO ENHANCE AVAILABILITY OF HARD-TO-GET LINES OF COVERAGE. THIS INFORMATION GETS DATED QUICKLY AND PROBABLY UNDERSTATES CURRENT STATUS.

o WEST VIRGINIA AND WYOMING ARE SERIOUSLY CONSIDERING ESTABLISHING COMPREHENSIVE SELF-INSURANCE FUNDS.

o CALIFORNIA'S SPEAKER OF THE HOUSE HAS CALLED FOR ESTABLISHMENT OF A STATE BOARD TO REVIEW INSURANCE RATES AND A STATE FUND TO INSURE COUNTIES AND CITIES.

o NEW YORK STATE IS CONTEMPLATING A 60-DAY MANDATORY NOTICE FOR NONRENEWALS AND PREMIUM CHANGES. SIMILAR LEGISLATION PASSED IN WASHINGTON STATE IN 1985.

o MICHIGAN'S SENATE HAS PASSED LEGISLATION CAPPING AWARDS FOR MEDICAL MALPRACTICE WHILE CONNECTICUT IS LOOKING AT LIMITING LAWYERS' FEES AND CAPPING PAIN AND SUFFERING AWARDS.

o PURSUANT TO AN EXTENSIVE STUDY OF THE STATE'S MUNICIPAL LIABILITY, NEW YORK MAY CONSIDER LIMITING JOINT AND SEVERAL LIABILITY AND ASSIGNING LAWSUITS AGAINST CITIES TO NONJURY TRIALS.

o AT LEAST 4 STATES (MISSOURI, OREGON, PENNSYLVANIA AND SOUTH CAROLINA) APPEAR TO HAVE INSTALLED CENTRALIZED RISK MANAGEMENT SYSTEMS.

o CALIFORNIA'S STATUTE RESTRICTING ATTORNEYS' FEES HAS BEEN UPHELD BY THE SUPREME COURT. ILLINOIS' DAMAGE CAPS HAVE EXPERIENCED OPPOSITE FATE IN THAT STATE'S TRIBUNALS.

o IN VERMONT, LEGISLATION AUTHORIZING OUR COMMISSIONER TO ESTABLISH JOINT UNDERWRITING ASSOCIATIONS HAS PASSED THE HOUSE. MY COLLEAGUES ALSO HAVE UNDER CONSIDERATION BILLS WHICH WOULD CAP ATTORNEYS' CONTINGENCY FEES AND LIMIT NON-ECONOMIC DAMAGES. A MARKET ASSISTANCE PLAN WAS ESTABLISHED IN JANUARY.

BECAUSE THE PROBLEMS CONFRONTING STATE LAWMAKERS ARE MULTIPLE, IT IS EXTREMELY DIFFICULT TO ASSERT THAT ANY ONE ACTION OR GROUP OF ACTIONS WILL REMEDY THE ENTIRE CRISIS. AS WITH THE MID-70'S CRISIS WITH MEDICAL MALPRACTICE, THE LIKELIHOOD FOR SOLVING AVAILABILITY PROBLEMS ARE RELATIVELY GOOD. PRICE, HOWEVER, REMAINS A MORE SERIOUS CHALLENGE. STATES NEED TIME TO ASSESS WHAT WILL AND WILL NOT WORK TO ELIMINATE OR CURB THE CRISIS. MARKETPLACE RECOVERY IS LIKELY TO BE OF ASSISTANCE, BUT IT MAY COME TOO LATE FOR THOSE

"GOING BARE" OR REQUIRING INSURANCE TO CONDUCT BUSINESS OR PROVIDE SERVICES.

STATE REMEDIES

COMBING THROUGH THE VOLUMINOUS MATERIALS BEING COMPLETED BY STATES TODAY, IT IS OBVIOUS THAT THE SOLUTIONS BEING DISCUSSED AND IMPLEMENTED ARE EXCEPTIONALLY VARIED. SOME, AS MARKET ASSISTANCE PLANS, APPEAR TO BE SHORT-TERM REMEDIES. OTHERS, AS SELF-INSURANCE PLANS OR INCREASED RISK POOLING, MAY PROTECT GOVERNMENT AND THE PRIVATE SECTOR FROM INSURANCE CYCLES. SOME TORT REFORM INITIATIVES MIGHT TEMPER LOSSES AND BRING SOME SENSE OF PREDICTABILITY TO UNDERWRITING. I USE TERMS AS "MAY", "APPEAR" AND "MIGHT" BECAUSE NOTHING LOOMS AS AN ABSOLUTE CERTAINTY AT THIS STAGE OF THE CRISIS.

A LENGTHY ROSTER OF ALTERNATIVE SOLUTIONS EITHER BEING DISCUSSED OR ALREADY IN PLACE AMONG THE STATES FOLLOWS. I SUBMIT THIS LIST NOT TO PRODUCE A LONGER PIECE OF TESTIMONY BUT RATHER TO APPRISE YOU OF THE DIVERSITY OF APPROACHES BEING PURSUED. NCSL IS REVIEWING THE INCIDENCE WITH WHICH EACH OF THESE IS APPEARING. THE ORGANIZATION IS ALSO ATTEMPTING TO DOCUMENT WHAT IMPACT, BOTH SHORT-AND LONG-TERM, THESE POTENTIAL REMEDIES MAY HAVE ON AVAILABILITY AND AFFORDABILITY OF LIABILITY INSURANCE. AS YOU CAN IMAGINE, THIS IS A TEDIOUS ENDEAVOR WITH UNCERTAIN OUTCOMES AT THIS POINT.

NCSL DOES NOT ENDORSE ANY ONE OF THESE SOLUTIONS SINCE IT IS NOT THE ORGANIZATION'S MISSION TO TELL STATES WHAT TO DO OR NOT TO DO. ARGUMENTS ABOUND AS TO WHICH ALTERNATIVES WILL DIRECTLY AND EXPEDITIOUSLY ENHANCE AVAILABILITY, TEMPER PRICE CYCLES AND ENHANCE PREDICTABILITY.

FOR SIMPLICITY'S SAKE, I HAVE CLASSIFIED POTENTIAL REMEDIES IN FOUR CATEGORIES:

1) REGULATORY INITIATIVES:

- PROHIBITIONS AND RESTRICTIONS ON MIDTERM CANCELLATION AND NONRENEWALS.
- REQUIRING PRIOR APPROVAL OF RATES RATHER THAN FILE AND USE ARRANGEMENTS.
- JOINT UNDERWRITING ASSOCIATIONS.
- MARKET ASSISTANCE PLANS.
- MODIFICATION OF OPEN COMPETITION RATING ACTS.
- UPGRADING STATE INSURANCE DEPARTMENT MANPOWER AND RESOURCES.
- REQUIRING RATES TO REFLECT LOSS EXPERIENCE.
- UTILIZATION OF "CLAIMS MADE" RATHER THAN "OCCURENCE BASED" POLICIES.
- IMPROVED REGULATION OF NEW ENTRANTS.
- REGULATION OF SURPLUS LINE PROVIDERS.
- REQUIRING SUBMISSION OF DATA REGARDING INCIDENCE AND SEVERITY OF CLAIMS LOSSES.
- LOWERING "SURPLUS" RATIOS FOR SPECIFIC LINES OF COVERAGE.
- LIMITING THE PERCENTAGE AMOUNT WHICH AN INSURER CAN VARY RATES FROM THE FIXED RATE.

2) RISK MANAGEMENT:

- ESTABLISH RISK RETENTION POOLS FOR CERTAIN LINES OF COVERAGE.
- STRENGTHEN DISCIPLINARY PROCEDURES IN ALL STATE AGENCIES REGULATING PROFESSIONS.

- ENHANCE HAZARD MANAGEMENT AND PUBLIC SAFETY.
- STRENGTHEN RISK ASSESSMENT TECHNIQUES.

3) MARKETPLACE INTERVENTION:

- LIMIT POLICY EXCLUSIONS.
- AUTHORIZE BANKS AND THRIFTS TO ENGAGE IN INSURANCE ACTIVITIES.
- REVIEW THE NEED FOR MANDATORY COVERAGE AND MANDATED LEVELS OF COVERAGE.
- RESTRICT ANNUAL PREMIUM INCREASES/DECREASES BASED ON EVIDENCE OF CHANGE IN RISK.
- REQUIRE NOTICE TO INSUREDS REGARDING CANCELLATIONS AND/OR NONRENEWALS.
- PROVIDE EXCESS PROFITS STANDARDS.
- ESTABLISH OR EXPAND RISK POOLING AUTHORITY.
- ESTABLISH OR EXPAND STATE REINSURANCE, BACKUP INSURANCE AND SELF-INSURANCE PROGRAMS.
- PROHIBIT SURPLUS LINE PROVIDERS UNLESS APPROPRIATELY LICENSED.

4) TORT REFORMS:

- ESTABLISH COURTS OF CLAIMS TO HEAR SUITS AGAINST GOVERNMENT DEFENDANTS.
- ESTABLISH PRETRIAL SCREENING PANELS TO DETERMINE VALIDITY OF SUITS.
- IMPOSE PENALTIES FOR FILING FRIVOLOUS SUITS.
- ABOLISH/LIMIT PREJUDGEMENT INTEREST AWARDS.
- CAP NON-ECONOMIC AND PUNITIVE DAMAGES.

- CAP ATTORNEYS' FEES.
- ABOLISH OR MODIFY THE COLLATERAL SOURCE RULE AND JOINT AND SEVERAL LIABILITY.
- AUTHORIZE STRUCTURED SETTLEMENTS AND ITEMIZED JURY VERDICTS.
- REDEFINE STANDARDS OF CAPE.
- REVITALIZE A RESTRICTED FORM OF SOVEREIGN IMMUNITY.
- MODIFY STATUTES OF LIMITATION.
- AUTHORIZE JUDGES ONLY TO DETERMINE DAMAGE AND AWARD AMOUNTS.
- ADOPT COMPARATIVE NEGLIGENCE STANDARDS.
- LIMIT THE DISCOVERY PROCESS.

FEDERAL ROLE

WHAT SHOULD THE U.S. CONGRESS DO TO RELIEVE THE COST AND UNAVAILABILITY OF LIABILITY INSURANCE? NCSL BELIEVES THE FOLLOWING STEPS WOULD BE MOST PRODUCTIVE FOR NOW:

1) PERMIT STATES TO WORK OUT THE PROBLEMS WITH AFFORDABILITY AND AVAILABILITY OF LIABILITY INSURANCE. THIS IS NOT A DISMISSAL OF THE POSSIBLE NEED FOR EXAMINING THE MCCARRAN-FERGUSON ACT, ANTI-TRUST EXEMPTIONS, FEDERAL REINSURANCE AND THE IDEA OF FEDERAL REGULATORY STANDARDS WHICH SOME GROUPS HAVE RAISED. THE POTENTIAL ROLE OF THE FEDERAL GOVERNMENT IN LIABILITY INSURANCE IS A SUBJECT WHICH NCSL'S STATE-FEDERAL ASSEMBLY WILL REVIEW FURTHER IN MAY, 1986. OVER HALF THE STATES WILL HAVE CONCLUDED THEIR SESSIONS BY THEN AND OUGHT TO HAVE AN EXCELLENT UNDERSTANDING OF STATE CAPACITY TO MANAGE THE VARIOUS ASPECTS OF EXISTING LIABILITY INSURANCE PROBLEMS. ADDITIONAL STATE TASK FORCE REPORTS

patient has prominent delusions, hallucinations, incoherence, and/or grossly disorganized behavior. Many homeless people in shelters will have these symptoms.

There are a number of different symptoms that schizophrenics can exhibit. A schizophrenic may lack the ability to organize his/her thoughts into a coherent pattern so that thought A leads to thought B and thought C logically flows from thought B. His/her speech may be so totally disorganized as to resemble what has been called a "word salad." For example, the patient may declare, "In the universe of concept and the red emperor grape God is dead."

Schizophrenics also have difficulty in forming interpersonal relationships and therefore tend to isolate themselves from other people. Estrangement from their family members is common. The range of mood and emotion which the schizophrenic can express is often very narrow. Whether the schizophrenic is happy or upset, he often presents the same appearance and expression.

Moreover, many schizophrenics maintain simple or elaborate belief systems which are delusional in nature and without any basis in reality. They may also have auditory

AND ISSUE ANALYSES SHOULD ALSO SERVE TO AID STATE LAWMAKERS IN ASSESSING THE NEED FOR ANY CONGRESSIONAL ACTION.

2) TAKE CORRECTIVE ACTION AT THE FEDERAL LEVEL IN AREAS, AS ENVIRONMENTAL LIABILITY INSURANCE, TRUCKERS' COVERAGE AND THE PRICE-ANDERSON ACT, WHERE THE FEDERAL GOVERNMENT ALREADY HAS JURISDICTION.

3) COOPERATE WITH ORGANIZATIONS AS NCSL AND OTHER LOCAL AND STATE GOVERNMENTS AND THEIR ORGANIZATIONS TO IDENTIFY REMEDIES WHICH WILL POTENTIALLY WORK TO ENSURE THAT SITUATIONS AS WE HAVE TODAY DO NOT RECUR.

4) INTERVENE WHEN IT APPEARS THAT STATES HAVE EXHAUSTED ALL PROPOSED REMEDIES, ANALYZED THEIR IMPACT, AND HAVE FOUND THAT PROBLEMS WITH AFFORDABILITY AND/OR AVAILABILITY PERSIST.

5) CONTINUE HEARINGS SUCH AS THESE WHICH CAN HEIGHTEN THE UNDERSTANDING OF THE EXISTING CRISIS AND PROVIDE A FORUM FOR REMAINING CURRENT ON STATE DEVELOPMENTS. THIS ISSUE IS A MOVING TARGET WITH NATIONWIDE AND EVEN INTERNATIONAL OVERTONES. NCSL WILL BE MORE THAN GLAD TO ASSIST WITH THE SUBCOMMITTEE'S FUTURE HEARINGS AND ANALYSIS THROUGH ADDITIONAL TESTIMONY AND PROVISION OF ITS PUBLICATIONS.

MR. CHAIRMAN, I WANT TO THANK YOU FOR EXTENDING THIS OPPORTUNITY TO THE NATIONAL CONFERENCE OF STATE LEGISLTURES TO PARTICIPATE IN THESE HEARINGS AND I WILL GLADLY RESPOND TO ANY QUESTIONS WHICH YOU AND OTHER MEMBERS OF THE SUBCOMMITTEE MIGHT HAVE.

STATE LEGISLATIVE REPORT

CONTROLLING LIABILITY INSURANCE COSTS: STATE ACTIONS AND FUTURE INITIATIVES IN THE AREA OF CIVIL JUSTICE REFORM

by

Brenda Trolin

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CONTROLLING LIABILITY INSURANCE COSTS: STATE ACTIONS AND FUTURE INITIATIVES IN THE AREA OF CIVIL JUSTICE REFORM

The rising costs and increasing unavailability of casualty insurance affects government, business and consumers, who are facing mid-term cancellations and non-renewals of their insurance, as well as society as a whole. Governments are often drawn into lawsuits and are drained financially by payment of huge awards, not because of their responsibility for the damage but because of their financial base. The price of products is increased to cover the cost of insurance. Fear of suits causes businesses to abandon new products involving risk. Research for developing technologies is hampered because companies are unable to afford the insurance necessary to test and market the research. Insurance costs for municipalities, day care centers, common carriers, schools, accountants, lawyers and physicians are doubling and tripling. Coverage for liquor liability and pollution is virtually impossible to obtain.

The question facing lawmakers is whether the problem will arrest itself or whether state legislatures will need to resolve it. A 1985 study by Insurance Services Office, a provider of statistical data to the insurance industry, projected that available property/casualty insurance may fall short of projected demand by $62 billion in the next three years. Ninety percent of that will affect commercial lines. According to the study, three factors must be addressed in order to relieve the problem: the unpredictability of judicial awards; the size of the awards; and the litigious nature of American society.

AN OVERVIEW

The tort liability problem is two-pronged. It affects both the public and the private sectors. Because governmental activities are broader in scope than business activities, governments are more susceptible to suit. It is only recently that government has lost its immunity from suit, either by judicial or legislative action. Historically, under the doctrine of sovereign immunity, citizens could not sue the government.

With the elimination or restriction of the doctrine of sovereign immunity, governments and governmental employees are responsible for damages in the same way that private individuals are. Some legal experts maintain this is a fair and equitable situation, while others maintain that the nature of governmental activities requires that governmental immunity be regarded in different terms. These are philosophical considerations with important practical effects.

With regard to the insurance problem itself, there appear to be four aspects of the issue which require review by the states: regulation of the insurance industry; reform of tort law; education of the public regarding the impact of an increasingly litigious society; and the development of effective risk management programs. Part of the current problem can be attributed to poor management practices of the insurance companies: reliance on high interest rates for profit margins rather than charging adequate premium rates to cover losses; increase of rates in certain lines without losses to justify the increase; and undercapitalization of many new entrants

into the market. These practices could be avoided by tighter regulation of the industry.

Currently, considerable debate surrounds the role of the legal system in the insurance crisis. Critics contend that the system is responsible for the high cost of insurance (two to five times greater than in 1984) and, in some cases, its unavailability. They argue that the lengthy process, high awards and unpredictability of the outcome have made financial planning for future claims difficult and have created severe financial problems for insurance companies.

On the other hand, expanded services provided by state, and particularly local, government attract many more suits. Doctrines such as joint and several liability and the collateral source rule force governments to assume responsibility for a larger proportion of the damages than they were in fact responsible for in the past.

A corollary to the reform of the civil justice system is the litigious nature of American society. An NCSL survey (December 1985) found that even in states where tort reform legislation has been enacted and has effectively reduced the size of damage awards, there has been a steady increase in the number of suits filed. There seems to be a general perception that when the public sues the state, it is suing some abstract entity, when in fact taxpayers are ultimately the source of the money used to pay these judgments. The same is true of suing insurance companies. Policyholders buy into a risk pool with finite resources made up of the premium payments. Huge damage awards which drain this pool create deficits for insurance companies which then must increase premiums to cover losses or refuse to insure the activity due to its highly risky nature.

Effective risk management programs can minimize losses by financing and controlling exposure to risk. Elements of such a program include risk identification, risk evaluation, safety programs designed to avoid or reduce risk and funding mechanisms for losses due to unavoidable risk.

This State Legislative Report is the first in a three-part series which addresses the issue of tort liability as it affects state and local governments. This report highlights state and federal tort reform proposals, and the possible effectiveness of such proposals.

PUBLIC POLICY ISSUES

Because reform of the civil justice system involves the determination of important public policy questions, revisions in the existing system must be approached cautiously. As John Prather Brown of the Law Firm of Principal, Chase, Brown & Blaxall, Inc., points out, "The legal responsibility for personal injury is at the center of an intricate web of issues. Crafting a wise alternative to the present legal system will require care, consideration and meticulous attention to detail. The issues raised by the tort system and by the impact of possible changes are not just legal issues, and they are not just lawyers' issues. They are broad in effect and raise important political, philosophical and economic questions."

The goal of reform is the creation of a civil justice system which balances the right of the individual to recover damages for injuries resulting from the negligent acts of others and the rights of society to be free

from the specter of financial ruin resulting from the uncertainty of the results of these lawsuits. The development of a system providing fair and adequate awards for legitimate claims, which does not overcompensate or create legal rules which inhibit day-to-day activities, is not easy to achieve. Consideration must be given to balancing the litigants' constitutional rights of due process and equal protection with the necessity of streamlining court procedures.

Changes in tort law can encourage or discourage lawsuits. Lowering the cost of litigation could, for example, increase the number of cases filed because more people could afford to sue. If it were coupled with a stringent law on the filing of frivolous suits, the result might be that individuals with legitimate claims would find it easier to use the system.

Legislation can provide incentives or disincentives, so careful consideration must be given to the effects of each proposal individually and in combination with other proposals. The present system, for example, provides incentives for doctors to require additional tests that may be unnecessary to provide evidence that will show "reasonable behavior" in anticipation of a lawsuit. The lawsuit may or may not happen, but the patient has been subjected to unnecessary testing and increased medical expenses.

The needs of a variety of interest groups must be weighed within the framework of reform. Business cites the need for new product liability laws which will encourage a better climate to research, develop and market products. Professionals cite the need for freedom to practice their professions without constant fear of lawsuits and unaffordable insurance costs. Many non-profit organizations state they are unable to carry out public programs because of unaffordable insurance premiums. These interests must be balanced against the necessity of providing compensation to individuals who are injured by the carelessness and negligence of others.

Many states that did pass medical malpractice tort reforms are still experiencing problems related to medical malpractice liability insurance and raise a number of questions. Were the reforms extensive enough? Were there conflicting reforms which cancelled each other out? Did some reforms create more problems than they solved, or are other factors substantially responsible for the current situation? Should serious alternatives be considered for compensating individuals who have been injured?

The gravity of revising the civil justice system argues for evaluation and data collection in order to judge the outcome of any tort reforms.

ALTERNATIVES

Many proposals to reform the civil justice system are currently being considered by state legislatures. The following discussion provides a description of the major proposals and an example of an alternative to the present system. These alternatives are only examples and are not intended as suggested solutions.

AWARD OF DAMAGES

Establish Limits on Non-economic Damages

Because it is difficult to assign dollar amounts to non-economic damages, such as pain and suffering and mental anguish, awards vary greatly from one jury to the next. While compensation for physical, mental or emotional stress may in fact be justified, the unpredictability of jury awards has resulted in higher insurance premiums.

Alternative Measures: A $250,000 cap on non-economic awards for medical malpractice suits enacted in California was upheld by the U.S. Supreme Court in October, 1985. Such a ceiling or cap on pain and suffering awards provides some predictability to the system and provides some rational limits to an issue which is highly emotional. A study conducted by the Rand Corporation on the effects of caps on medical malpractice suit awards found that "when a state moved to cap verdicts or eliminate specific dollar requests by plaintiffs or permit payment of awards for future losses in periodic installments, the net effect was to reduce trial awards by 30 percent, cut the average out-of-court settlement by 25 percent, raise the portion of cases dropped from 43 percent to 48 percent, and reduce the share of cases going to actual verdict from 5.1 to 4.6 percent." [The Resolution of Medical Malpractice Claims: Research Results and Policy Implications (R-2793-ICJ), by Patricia Munch Danzon and Lee A. Lillard]

Abolition or Restriction of Punitive Damages

Punitive damages are those awarded in addition to compensatory damages and designed to punish the defendants for malicious acts. Since damages are intended to provide the plaintiff with compensation for an injury, the nature of punitive damages may make the judgment overvalued in that they represent monies in addition to the cost of compensation for injury.

Alternative Measure: Punitive damages contribute to the unpredictability and size of awards. Alternatives to the complete abolition of punitive damages include options such as placing caps on awards, redefining standards of conduct and shifting the burden of proof for such awards, as well as placing limitations on multiple punitive damage awards, and may be workable alternatives.

Itemized Jury Verdicts

The unpredictability of jury awards contributes to the inability of insurance companies to plan for claims and thus encourages higher premiums. It may also result in inequities to the plaintiff since recovery for damages is dependent on the makeup of the jury and the emotional state of the jurors.

Alternative Measure: To create a more consistent standard, the jury could be instructed to itemize damages into categories based on medical expenses, lost wages, non-economic compensation and other specific items. Such an accounting could provide a framework for the jury to use.

Adoption of Structured Settlements

Lump sum payments of awards have several drawbacks. Large awards payable at one time create unnecessary financing problems for the defendant and do not necessarily work in favor of the plaintiff. For example, studies of lump sum payments in workers' compensation indicate that the money is not always wisely invested and may not sustain the injured party through his lifetime.

Alternative Solution. The adoption of structured settlements permits payment of awards in periodic payments. Such installment payments are less expensive to finance and guarantee the injured party financial security. The Danzcn-Lillard study (R-2793-ICJ) concluded that structured settlements reduced the average settlement by 25 percent and reduced the number of cases going to verdict from 5.1 percent to 4.6 percent.

Abolition of Collateral Source Rule

Under the collateral source rule, the jury is not permitted to hear evidence regarding compensation which the plaintiff may receive from other sources. A plaintiff may therefore be doubly compensated since various sources of compensation are not considered. In addition, the rule may increase litigation by forcing the defendants to go through the legal process to resolve the controversy related to overpayment by one defendant.

Alternative Solution: Relaxation of the collateral source rule to allow consideration of all sources of funding available for payment of damages. Another alternative would be the mandatory offset of the collateral source rule. That is, additional recoveries received would be subtracted from the award. The Rand study suggests that this revision would result in an 18 percent savings.

Contingent Fees

Contingent fees are received by a lawyer who contracts with a client for a percentage of the award rather than receiving a fee based on an hourly rate or some predetermined amount. Attorneys' contingent fees generally range from 25-5D percent of the settlement. Contingent fees may encourage demands for higher settlements and may not reflect the time, effort, skill or value of the service rendered. A 1984 study conducted by the American Bar Association indicated that reduction in time spent on a case by an attorney resulted in savings to clients who paid an hourly rate, but not to clients who had a contingent fee arrangement.

Alternative Measure: The adoption of mandatory sliding fee schedules, such as the plan adopted in California, would allow for the legitimate benefits which are derived from contingent fees (providing legal services for those who might not otherwise be able to afford them). Sliding fee schedules also ensure a greater share for the injured client.

In November, 1985, the U.S. Supreme Court upheld a California statute limiting legal fees paid by the client. The sliding fee schedule permits a 4D percent fee when the damages are $5D,DDD or less; 33.3 percent for an additional $5D,DDD; 25 percent on the next $1DD,000; and 1D percent above $2DD,DDD.

The Danzon-Lillard study (R-2793-ICJ) found that limitations on attorneys' contingent fees apparently "cut the average settlement by 9 percent; raised the portion of cases dropped from 43 percent to 48 percent; and reduced the share of cases going to verdict from 6.1 percent to 4.6 percent."

Abolition of Joint and Several Liability Doctrine

The doctrine of joint and several liability is based on the concept that when the negligence of two or more individuals results in injury to a person, the tortfeasors are jointly and individually liable for damages. It permits a plaintiff to recover the entire amount of the judgment from one defendant, forcing that individual to recover from the other defendants. The degree of negligence of the defendants is not a consideration since the defendant who is 1 percent negligent may end up paying the entire judgment. State and local governments, often viewed as having unlimited rescurces, become favorite targets in lawsuits.

Alternative Measure: One means of addressing this problem is to adopt a form of comparative negligence which allows the plaintiff to recover damages only if the defendant's negligence is greater than the plaintiff's. The justification for such a policy is the fact that a plaintiff who is more responsible for his injury than the defendant should not be able to recover damages.

Another alternative found in the Uniform Comparative Fault Act makes each defendant liable for their proportionate share based on their degree of fault. According to a national survey on governmental tort liability by the New York City Law Department, language for such a bill would be as follows:

"Upon motion made no later than [one year] after judgment is entered, the court shall determine whether all or part of the party's equitable share of the obligation is uncollectible from that party, and shall reallocate any uncollectible amount among other parties, including a claimant at fault, according to their respective percentages at fault. The party whose liability is reallocated is nonetheless subject to contribution and to any continuing liability to the claimant on the judgment."

This alternative also has the advantage of assuring compensation to the plaintiff and distributing any portion an insolvent defendant owes among the remaining defendants based on their percentage of fault. Another alternative distributes liability proportionally but does not provide for insolvent defendants. A complete discussion can be found in Pearson, Apportionment of Losses Under Comparative Fault Laws - An Analysis of the Alternatives, 40 La. L. Rev. 343, 364 (1980) and Note, Damage Apportionment in Maine: A Proposal for Reform, 34 Me. L. Rev. 367, 396 (1982).

PROCEDURAL REFORMS

Four major proposals include:

1) Modification of the Statute of Limitations. A number of state laws permit negligence suits to be filed many years after the alleged negligent act occurred. Where minors are involved, the payment of damages may result 18 years or longer after the incident. A statute of limitations which would provide a more reasonable time period for discovery of the

injury and filing of the claim would contribute to an insurance company's ability to predict claims and plan for their payment.

2) Allow Affidavits for Noninvolvement. To discourage the practice of joining every individual in a lawsuit who may have some remote connection, a defendant should be allowed to file an affidavit of noninvolvement denying connection to the negligent act. A hearing would then be held requiring the plaintiff to show reasonable cause for naming the individual as a defendant in the suit.

3) Permit a System of Binding, Voluntary Arbitration. Arbitration could be used in less complex cases as a faster, less costly means of resolving small claims. By diverting these cases to an alternative system, the traditional court system would be freed to more quickly expedite more complex cases, reducing costs to the courts and litigants. The Institute of Civil Justice is currently conducting a study to evaluate litigant reactions and litigant costs in court-annexed arbitration in federal courts.

4) Expedite Proceedings. Patricia A. Ebener of the Rand Institute conducted a national survey of state court procedures designed to reduce delays in civil court procedures. Her study found 25 procedures implemented in 47 states. These include:

   1. "Fast tracks" for certain types of cases;

   2. Dismissal of inactive cases;

   3. Penalties for last minute settlements made after courtroom assignment and jury selection;

   4. Procedures designed to simplify and limit filing of motions and pleadings; procedures limiting discovery;

   5. Procedures which set firm trial dates;

   6. Procedures which provide faster and less expensive means of resolving disputes.

Evaluation of Reforms

Critical to the process of revising the legal system is developing procedures for measuring the effectiveness of these reforms. During the 1970s, a number of legislatures enacted tort reforms addressing the medical malpractice liability issue, but many did not establish monitoring systems to measure the effectiveness of the reforms or procedures to collect and analyze data. It is difficult to determine which reforms were effective and which were not since these states are still experiencing problems related to availability of insurance.

The Rand Institute on Civil Justice has conducted some studies on these state reforms, but they have been hampered by a lack of data. According to the Institute, "The model must be regarded as preliminary; it must be applied to more data sets before its validity can be precisely judged. Gaps and inadequacies in the data used so far make the conclusions tentative."

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With these precautions in mind, certain observations on tort reform related to medical malpractice can be made.

Current practices have resulted in a system in which the cost of litigation equals the compensation received by the plaintiffs. Small claims, even with merit, are often dropped due to the cost of litigation. However, policymakers must realize that a reduction in litigation costs could result in an "increase in the number of cases filed, a decrease in the percentage dropped without payment, an increase in average settlement size and an increase in the number of cases taken to verdict." With an increase in litigation, there would be more pressure on the already congested judicial system.

Effects of Changes in Tort Law

An analysis of the Rand study provides evidence on the direction and order of magnitude of the short-run effects of some of the changes enacted in the mid-1970's. Dollar caps on awards, elimination of specific dollar claims by the plaintiff and authorization of installment payment of large awards appear to have significantly reduced jury awards and settlements in the states where they were enacted. Modification of the collateral source rule to admit evidence that the plaintiff is eligible for compensation from other sources has apparently had a much weaker effect. Statutory limits on the contingent fees charged by plaintiffs' attorneys appear to have had moderately depressive effects on settlement amounts and on the number of cases going to verdict, while somewhat increasing the proportion of cases dropped.

The study did not attempt to identify the effects of other measures enacted by various states, including measures to reduce the statute of limitations; to limit the circumstances in which a presumption of defendant liability is created (res ipsa loquitur); to make it easier to prove the patient's informed consent to a medical procedure; to introduce expert pretrial panels to screen claims for their merit; or to permit binding arbitration.

This study suggests that there are standards of measurement available to evaluate tort reforms. By compiling statistics on whether there has been a reduction or an increase in suits settled out of court, whether there has been a reduction in size of judgments, whether judges have revised jury verdicts, whether there has been a reduction in the number of suits filed, legislators would have objective standards to judge the effectiveness of tort reform. It would be worthwhile, upon passage of tort reform legislation, to establish a system for collecting data to develop a statistically significant measure of the effectiveness of tort reform. Development of such information would put an end to the controversy surrounding tort reform and be useful in revision of ineffective reforms in the future.

FEDERAL INITIATIVES ON TORT REFORM

After the United States Supreme Court held that the insurance industry was subject to federal regulation (United States v. South-Eastern Underwriters Association, 322 U.S. 533 (1944), Congress enacted the McCarran Act of 1945, 59 Stat. 33, U.S.C. Sec. 1011 et seq., supporting the continued regulation of the insurance industry by the states. Current discussion in Washington includes a review of the efficacy of this federal position as

well as numerous other proposals to modify the regulatory scheme. Bills pertaining to the regulation of product liability and medical malpractice litigation provide examples of federal initiatives.

Product Liability

Two federal bills were introduced in 1985 dealing with product liability. Senator Bob Kasten (Wisconsin) introduced S.B. 100 to regulate interstate commerce by providing a uniform product liability law. The bill requires proof of negligence on the part of the manufacturer and provides for a two-year statute of limitations on the filing of a suit.

An alternative to S.B. 100 is an amendment to S.B. 44, The Product Liability Act, introduced in 1984. The amendment is sponsored by Senators Christopher Dodd (Connecticut) and Slade Gorton (Washington). The amendment does not require proof of negligence, but provides an alternative for injured parties to the traditional lawsuit by allowing them to receive compensation in a speeded-up claims process, which recognizes economic losses such as medical costs and lost earnings. Disagreements would be resolved by arbitration.

Medical Malpractice

The Medical Offer and Recovery Act of 1985 (H.R. 3084) sponsored by Congressmen Henson Moore (Louisiana) and Richard Gephardt (Missouri) addresses issues related to malpractice litigation. Provisions of the bill outline a model for state legislation and federal provisions for states which do not enact similar mechanisms. Provisions of the bill include:

1) An alternative allowing health care providers, within 180 days of incident, to authorize payment of patient's economic loss;

2) Foreclosure of a patient's right to sue for medical malpractice once the provider's commitment to pay for economic loss is made, with two exceptions: a) cases where the provider intentionally caused the injury; b) wrongful death;

3) Offer of provider must by definition encompass all of patient's economic losses;

4) Provider may join all other responsible parties with disputes between joined parties being settled by arbitration;

5) Periodic payments.

The patient's right to sue for enforcement should the provider default or breach the agreement is protected under the bill's provisions. It also allows lump sum payments under certain circumstances; assures patients of payment; permits patients to demand compensation for economic loss without going through the expensive, lengthy litigation process; requires reporting to state health care licensing authorities to reduce malpractice by incompetent health care providers.

FEDERAL COURTS AND LOCAL GOVERNMENT LIABILITY

In recent years local governments have experienced rapidly expanding liability under federal antitrust and civil rights laws. Time spent litigating these cases has proved expensive for states in terms of the attorneys' general time and private attorneys' fees and damages. According to Beth Farmer of the National Association of Attorneys General, the states received some relief in regard to antitrust laws with passage of federal legislation in May, 1985. This legislation clarified the application of the federal antitrust laws to the official conduct of local governments, reducing suits against them. The primary benefit to local government was that awards under antitrust laws included triple damages. However, litigation arising from 42 U.S.C. Section 1983 (civil rights legislation) continues to be a significant source of state litigation and may increase for several reasons. First, the argument which persuaded Congress to provide relief under antitrust laws was that the injured party could still, in many cases, file suit under 42 U.S.C. Section 1983 for damages (no triple damage awards). George Yuhas, Chairman of the American Bar Association Committee on Government Liability, points out that some suits currently filed against local governments for tort actions also carry elements of violation of civil rights actions under 42 U.S.C. Section 1983. With the passage of state tort reform laws, suits of this nature may be filed under the federal law to avoid tort reform measures such as caps, structured settlements and limitations on attorneys' fees. States should be prepared to deal with such contingencies.

SURVEY

A survey on tort reform legislation is included in this report (Appendix A). The respondents were legislative drafting offices and state attorneys' general offices.

Generally, states are listing the following topics for serious consideration: municipal immunity; limitation on pain and suffering awards; limitations on attorneys' fees; dram shop legislation; comparative negligence (several states are considering adoption of the Uniform Comparative Fault Act), medical malpractice legislation; elimination of joint and several liability doctrine; reduction of statute of limitations; limitation of governmental liability for damage or injury resulting from hazardous recreational activities; limitation of liability for providing emergency medical care rendered by a physician-trained mobile intensive care paramedic.

Topics also include abolition of jury trials in cases against public entities or trial to judge on damage issue; establishment of legal duty for various activities; limitation of liability for torts related to toxic wastes; creation of pretrial screening panels; limitation on liability for highway design, construction and maintenance; modification of statute of limitations for legal actions against architects, construction managers, professional engineers or contractors for improper or negligent improvements to real property; requiring that losing litigants pay court costs and attorneys' fees in some circumstances (similar to Federal Rules of Procedure 68).

While most states that have enacted tort reforms report that the legislation has been effective in limiting the size of awards, they note steady increases in the number of suits filed due to decline in the use of the doctrine of sovereign immunity. States also cite the increasing number of

suits filed under 42 U.S.C. 1983 statutes and the lack of control that the states have in modifying these federal statutes.

The State of Tennessee reported that portions of the "Medical Malpractice Review Board and Claims Act of 1975," Tennessee Code Annotated, Sections 29-26-114, 29-26, 121, were repealed in 1985 due to ineffectiveness. Statistics for total tort or damage suits filed in Circuit and Chancery Courts in 1974 numbered 11,064; in 1984, 11,775 (Source: Executive Secretary, Supreme Court of Tennessee, Annual Report 1974 and 1984).

Recommendations

The majority of states responding to the survey supported two proposals:

1) Cap on "non-economic damages," and

2) Modification of collateral source rule.

Various states made the following suggestions.

1) Limitation of punitive damages to a set amount or percentage of assets, whichever is greater.

2) Legislation that treats public entities and public employees identically for procedural requirements.

3) Legislation limiting public entities' contribution to any judgment to an amount not greater than its pro rata share of liability.

4) In assessing legislation, an important consideration is the ramifications of proposed legislation on practical as well as constitutional issues. Critical to the selection of appropriate legislation is the determination of the source from which the so-called problems originate--attorneys' actions, insurance industry actions or other causes.

5) Enactment of standards permitting waivers of rights to sue for damages for use by schools, churches, and non-profit organizations.

6) Enactment of market assistance plans.

7) Enactment of more limited standards of duty than are currently in use.

8) Abolition of jury trials in cases against public entities or trial to judge on damages issues;

9) Return to restricted form of sovereign immunity;

10) Creation of pretrial screening panels to determine validity of suit.

11) Legislation prohibiting a public entity's contributing to a judgment more than its pro rata share of liability.

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12) Awards to state of any assessment of punitive damages.

Virtually every state has created a task force to study the liability insurance problem. In addition to tort reform measures, states are also reviewing regulations in the insurance industry.

Recommendations for the upcoming sessions include legislation which would: 1) place tighter restrictions on cancellation and renewal policies of insurance companies; 2) establish self-insurance plans for state and local governments; 3) regulate capital funr requirements of foreign and domestic insurers; alter structure of insurance settlement payments; 4) create joint underwriting associations; 5) modify "open competition" ratir act; 6) increase insurance department's authority to regulate rates; 7) provide for an excess profits law for commercial liability rates; 8) allow for group insurance for commercial liability risks; expand to various professional groups the authority to form a self-insurance trust; and 9) revise requirements for businesses to form a limited reciprocal insurer.

The State of Montana has been able to address some of the current problems through judicial decisions. The Montana Supreme Court has recognized the tort of violation of insurer's implied-in-law duty of good faith and fair dealing. First Security Bank v. Goddard, 181 M407, 593 P.2d 1040 (1979); Fowler v. State Farm Mutual Automobile Insurance Co., 153 M74, 454 P.2d 76 (1969).

CONCLUSION

The issues surrounding the liability insurance crisis are complex and do not admit to any easy solution. They require thoughtful, careful consideration. The success or failure of reform will depend to a great extent on the development of accurate data upon which decisions will be made. The majority of the states are presently engaged in this search. This report provides some information regarding the direction that states are taking. As legislatures consider this subject in 1986, NCSL will continue to monitor the progress of the legislatures and provide this data to interested persons.

The information in this State Legislative Report is based in part on committee meetings conducted in Williamsburg, Virginia in November, 1985. Participants included David Childers, Insurance Commissioner (Arizona); Matt Coffee, Lee Ruck, National Association of Counties; Don Jones, National League of Cities; John Gunther, United States Conference of Mayors; Jody Thomas, National Governors' Association; Wayne Campbell, National Federation of Independent Business; and Winnie Austerman, Office of Management and Budget. Additional information was supplied by the states in response to surveys. State reports also supplemented the research. A complete bibliography as well as more detailed information is available upon request.

ESTABLISHMENT OF ALTERNATIVE TO TRADITIONAL LITIGATION

1

ALABAMA	Ala. Code §6-5-485 (1975)
ALASKA *	Alaska Stat. §09.55.535 (Supp. 1983)
ARIZONA	--
ARKANSAS	--
CALIFORNIA	Cal. Civ. Proc. Code §1295 (West 1981)
COLORADO	--
CONNECTICUT	C.G.S.A. §§52-549 et seq. and 8-141 et seq.
DELAWARE	Chapter 682 (Arbitration Code)
FLORIDA *	-- Medical Mediation Panels ruled unconstitutional
GEORGIA	OCGA §§28-5-60 through 28-5-86
HAWAII *	Hawaii Revised Statutes, §§671-11 to 671-20
IDAHO	IC §6-1001 et seq. (medical malpractice claims)
ILLINOIS	Public Act 84-7, Ill. Rev. Stat., Ch. 110, par. 2-611.1
INDIANA	--
IOWA	--
KANSAS	--
KENTUCKY	K.R.S. Chapter 44
LOUISIANA	La. Rev. Stats. 13:5141-5157; 40:1299.41-1299.48
MAINE	14 MRSA §§1151-1155
MARYLAND *	Courts & Judicial Proceedings (CJ) Title 3, Subtitle 2 (1975)
MASSACHUSETTS *	-- See comments.
MICHIGAN	Mich. Comp. Laws Ann. §500.3051 to .3062
MINNESOTA *	Minnesota Statutes 1984, Ch. 454; see also 115B.25-115B.37 and 572.30
MISSISSIPPI	--
MISSOURI	Uniform Arbitration Act, §§435.350 to 435.470, RSMo. 1980, and H.B.120
MONTANA *	Ch. 449, L. 1977 (Title 27, Ch. 6, MCA); Ch. 684
NEBRASKA	--
NEVADA *	NRS 41A
NEW HAMPSHIRE	NHRSA 541-B
NEW JERSEY *	Yes
NEW MEXICO	--
NEW YORK *	Yes
NORTH CAROLINA	--
NORTH DAKOTA	--
OHIO *	Ohio Rev. Code Ann. §2711.21 to .24
OKLAHOMA	12 O.S.1984 §§1801 et seq.
OREGON *	See comments.
PENNSYLVANIA *	--
RHODE ISLAND	R.I. Gen. Laws §8-17-1
SOUTH CAROLINA *	§56-11-510, et seq. of S.C. Code
SOUTH DAKOTA	--
TENNESSEE	T.C.A. §9-8-101 through 9-8-406, re to claims against state only
TEXAS *	Article 4590, §6.03, Revised Statutes
UTAH	--
VERMONT	Vt. Stat. Ann. Title 12, §7002(a) (Supp. 1982)
VIRGINIA	Va. Code §§8.01-581.1 to 581.12:2 (Supp. 1983)
WASHINGTON	--
WEST VIRGINIA	--
WISCONSIN	--
WYOMING *	Proposal to create a pretrial screening panel
AMERICAN SAMOA	
GUAM	
PACIFIC TRUST	
PUERTO RICO	
VIRGIN ISLANDS	
TOTAL	

* See Comments.

ESTABLISHMENT OF ALTERNATIVE TO TRADITIONAL LITIGATION - Comments

ALASKA
1) AS 09.43.190-.220 (arbitration of small claims)
2) AS 09.43.010-.180 (Uniform Arbitration Act)
3) AS 09.55.535 (Voluntary Arbitration of Medical Malpractice Claims)

HAWAII
Hawaii Medical Malpractice: Haw. Rev. Stat. Ch. 672, Design Professionals

MARYLAND
Health Care Malpractice Claims

MASSACHUSETTS
Maximum amount increased in area of small claims; Superior court can now remand cases to District Court for trial when amount is under $15,000.

MINNESOTA
See also Minn. Stat. §§115B.25 to 115B.37 (only for hazardous substance injury); see also Minn. Stat. 572.30.

MONTANA
Montana L. 1985 (Title 27, Ch. 5, MCA). Medical Legal Panel Act; Uniform Arbitration Act.

NEVADA
Screening panel for medical malpractice actions.

NEW JERSEY
The State Supreme Court has instituted an arbitration program for automobile negligence claims where the amount in controversy does not exceed $15,000. / party has a right to de novo trial in Superior Court.

NEW YORK
The state may only be sued in Court of Claims (Court of Claims Act, §9). Arbitration is available in any case if all parties agree (CPLR, §7501). Medical malpractice actions must go to a medical malpractice panel (Judiciary Law, §148-a), but this does not preclude a civil trial.

OHIO
See R.C. 2711.21-2711.24 relative to medical claims arbitration. See R.C. 9.83(E) relative to administrative "compromises" of motor vehicle, watercraft, and aircraft claims against the state. See entire R.C. Chapter 2711. relative to arbitration (often contract disputes). Also see Municipal Court Superintendence Rule 15 and Common Pleas Court Superintendance Rule 15.

OREGON
Trial Court Rules establish non-binding arbitration for cases where less than $15,000 in damages are sought.

PENNSYLVANIA
Cities of Philadelphia and Pittsburgh provide arbitration for claims of $20,000 or less; others for $10,000 or less.

1b

ESTABLISHMENT OF ALTERNATIVE TO TRADITIONAL LITIGATION - Comments

SOUTH CAROLINA
South Carolina Laws, 1976, as amended (Arbitration of Property Damage Liability Claims); South Carolina Supreme Court has issued rules for voluntary arbitration of appeals and disputes over attorney fees.

TEXAS
Creation of Texas Medical Disclosure Panel to determine proper disclosure for every medical and surgical procedure.

2

ABOLITION OR MODIFICATION OF SOVEREIGN IMMUNITY

ALABAMA *	--
ALASKA *	AS 09.50.250-.280; AS 09.65.070
ARIZONA	A.R.S. §12-820 et seq.
ARKANSAS	A.S.A. §12-2901
CALIFORNIA	Cal. Govt. Code §815.2
COLORADO *	24-10-101 through 118 C.R.S. (1973); H.B. 1001 (1985)
CONNECTICUT *	C.G.S.A. §4-165; §7-308; §4-160
DELAWARE *	--
FLORIDA	§768.28, Fla. Stat. Ann.
GEORGIA	Article I, Sec. II, Par. IX (Georgia Constitution)
HAWAII	Haw. Rev. Stat. §662-1 (State Tort Liability Act)
IDAHO	I.C. §6-901 et seq.
ILLINOIS *	
INDIANA *	Ind. Code 34-4-16.5-1 et seq.
IOWA	I.C.A. §25A.1; I.C.A. §613A.1
KANSAS	K.S.A. 75-6101 et seq.
KENTUCKY	K.R.S. 44.070 (Board of Claims Act)
LOUISIANA *	La. Const. Art. 12, Sec. 10 (1974); R.S. 13:5106
MAINE	14 MRSA §8101 et seq. (Tort Claims Act)
MARYLAND	Md. Code Ann. Art. 43, §12-104
MASSACHUSETTS *	Massachusetts General Laws (Chapters 258 & 258A)
MICHIGAN	Mich. Stat. Ann. §3.996 (107)
MINNESOTA *	
MISSISSIPPI	H.B. 983 (1985); M.C. §11-46-1 et seq.
MISSOURI	§537.600, RSMo (L. 1978, H.B. 1650; A.L. 1985, S.B. 323)
MONTANA *	Chapter 675, L. 1983 (2-9-206, 2-9-207, 2-9-101 MCA)
NEBRASKA	Neb. Rev. Stat. §81-8.215 et seq.; §23-2307; §23-2413
NEVADA	NRS 41.031 et seq. ($50,000 limit under NRS 41.035)
NEW HAMPSHIRE *	1985 Laws, Chapter 441; N.H. Rev. Stat. Ann. §412.3
NEW JERSEY *	N.J.S.A. 59:1-1 et seq.
NEW MEXICO	N.M.S.A. §41-4-1 et seq.
NEW YORK	Court of Claims Act, Art. II §8; N.Y. Gen. Mun. Law §50-d
NORTH CAROLINA	N.C. §143-291; N.C. §153A-435
NORTH DAKOTA	North Dakota Century Code NDCC §32-12.1-03
OHIO *	O.R.C. §2743.01
OKLAHOMA	51 O.S.A. 1985, §151 et seq.
OREGON	ORS 30.260-30.300
PENNSYLVANIA *	42 Pa.C.S. §8522; 42 Pa. Stat. Ann. §8540
RHODE ISLAND *	R.I. Gen Laws §9-31-1; §9-31-2; §9-31-3; §9-31-4; §9-31-12
SOUTH CAROLINA *	--
SOUTH DAKOTA *	SDCL §§21-32-15 to 18
TENNESSEE	Tenn. Code Ann. §§29-20-101--29-20-407 (1980, 1985 Supp.)
TEXAS	Tex. Civ. Stat. Art. 6252-19b; Art. 6252-26
UTAH	U.C.A. §63-30-3 et seq.
VERMONT *	Vt. Stat. Ann. Tit. 12, §5601; Vt. Stat. Ann. Tit. 29, §1403
VIRGINIA	--
WASHINGTON	R.C.W. §4.92.010
WEST VIRGINIA	--
WISCONSIN *	--
WYOMING *	"Closed end" (1979) W.S. 1-39-101 through 119
AMERICAN SAMOA	
GUAM	
PACIFIC TRUST	
PUERTO RICO	
VIRGIN ISLANDS	
TOTAL	

* See Comments.

ABOLITION OR MODIFICATION OF SOVEREIGN IMMUNITY - Comments

ALABAMA

Article I, Section 14 of the Alabama Constitution prohibits the state from being made a party in a lawsuit. The legislature cannot consent to suit against the state, but it can pass bills to appropriate money for persons injured by state actions.

Two judicial decisions -- Jackson v. City of Florence, 294 Ala. 592, 320 So.2d 68 (1975) and Lorence v. Hospital Board of Morgan County 294 Ala. 614, 320 So.2d 631 (1975) abolished local government immunity. Section 11-1-2, Code of Alabama, has established liability limits to $100,000 per claim and $300,000 per occurrence.

ALASKA

1) Claims against state
2) Suits against incorporated units of local government

COLORADO

H.B. 1001 revised governmental immunity statutes (September 15, 1985). Evans v. Board of County Commissioner, 174 Colo. 97, 482 P.2d 968 (1971).

CONNECTICUT

State sovereign immunity is not abolished; State Claims Commission hears and may approve claims but only under $5,000; municipal immunity retained except in limited circumstances.

DELAWARE

Retains sovereign immunity (Article I, Section 9 of Delaware Constitution). The Supreme Court of Delaware has held that the defense of sovereign immunity may be waived only by legislative act.

FLORIDA

Caps of $100,000/$200,000 or greater amount for which insurance is provided.

ILLINOIS

Illinois Constitution, Article XIII, Section 4 abolishes sovereign immunity except as provided by General Assembly. Ill. Rev. Stat. 1983, Ch. 127, Par. 801 provides that the state may be a party only in the Court of Claims.

INDIANA

Campbell v. State (1972) Ind., 284 N.E.2d 733

LOUISIANA

Act No. 451-R.S. 42:1441.1-1441.4; R.S. 29:23.1
Act No. 452-R.S. 13:5106; 5109(A)
Act No. 453-R.S. 9:2798.1
Act No. 454-R.S. 9:2800

MASSACHUSETTS

$100,000 cap per occurrence where immunity is waived.

MINNESOTA

Minn. Stat. §§3.732 and 3.736 (Supp. 1985) (State); Minn. Stat. Ch. 466 (Supp. 1985) (Political Subdivisions).

ABOLITION OR MODIFICATION OF SOVEREIGN IMMUNITY - Comments

MONTANA
Chapter 419, L. 1985; Chapter 389, L. 1985 (2-9-101, 2-9-107, MCA). Sovereign immunity abolished in Constitutional Convention (1973).

NEW HAMPSHIRE
(Cont'd) §507-B:4.
$100,000 cap per occurrence where immunity is waived.

NEW JERSEY
Prohibits damages for pain and suffering except in cases of severe injury where medical expenses exceed $1,000.

OHIO
1) In the case of the State of Ohio, sovereign immunity was abolished in Am. Sub. H.B. 800 of the 110th General Assembly (Effective 1/1/75). R.C. 2743.01-2743.20.

2) In the case of Ohio's political subdivisions, sovereign immunity was abrogated by the Supreme Court in a series of decisions, but recently reestablished subject to specified areas of liability (Am. Sub. H.B. 176 of the 116th General Assembly, effective 11/20/85). R.C. 2744.01-2744.09.

PENNSYLVANIA
$500,000 cap per occurrence where immunity is waived; damages for pain and suffering prohibited except in cases of severe injury where medical expenses exceed $1,500.

RHODE ISLAND
$50,000 cap per occurrence where immunity is waived.

SOUTH CAROLINA
Doctrine of sovereign immunity was abrogated by McCall v. Batson (1985), 329 S.E.2d 741, H.B. 2266 "South Carolina Tort Claims Act" is pending.

SOUTH DAKOTA
Reinstatement and strengthening. The Governor has cancelled the state's liability policy as of December 1, 1985.

VERMONT
No liability except to extent of insurance coverage.

WISCONSIN
State employees, officers and agents can be sued in tort if the claimant complies with the notice requirements of §893.82 Stats; see also 895.52.

WYOMING
Judiciary Committee sponsoring bill for 1986 session which will further limit liability for highway design, construction and maintenance.

ABOLITION OR MODIFICATION
OF JOINT AND SEVERAL LIABILITY

ALABAMA	--
ALASKA	A.S. 09.16 (Alaska Uniform Contribution Among Tortfeasors Act)
ARIZONA	A.R.S. 12-2501 et seq.
ARKANSAS	--
CALIFORNIA	--
COLORADO	§13-21-111(3.5), C.R.S. H.B. 1231 (1985)
CONNECTICUT *	--
DELAWARE *	--
FLORIDA	No -- legislation proposed
GEORGIA	Enacted greater statutory protection against excessive exposure
HAWAII	No -- proposals for 1986 session
IDAHO	--
ILLINOIS	Ill. Rev. Stat. 1983, Ch. 70, Par. 301 et seq.
INDIANA *	
IOWA *	
KANSAS	K.S.A. 60-258a
KENTUCKY	--
LOUISIANA *	La. Civil Code Art. 2324; R.S. 9:3921
MAINE *	14 MRSA §156 (comparative negligence)
MARYLAND	--
MASSACHUSETTS *	
MICHIGAN	--
MINNESOTA *	--
MISSISSIPPI	--
MISSOURI	--
MONTANA	--
NEBRASKA	--
NEVADA *	NRS 41.141(3)
NEW HAMPSHIRE *	
NEW JERSEY	--
NEW MEXICO	--
NEW YORK *	--
NORTH CAROLINA	N.C. Gen. Stat. §1B-1 to 1B-6 (1983)
NORTH DAKOTA	NDCC §32-38-01
OHIO *	--
OKLAHOMA *	510.5 1984, §154(E)
OREGON	ORS 18.440 - 18.460 (Contribution Among Joint Tortfeasors)
PENNSYLVANIA *	See comments.
RHODE ISLAND *	R.I. Gen. Laws §10-6-3 (see 9-20-4)
SOUTH CAROLINA	--
SOUTH DAKOTA	--
TENNESSEE	--
TEXAS *	Chapters 32 and 33, Civil Practice & Remedies Code
UTAH	Enacted greater statutory protection against excessive exposure
VERMONT	Eliminated the concept of joint and several liability
VIRGINIA	--
WASHINGTON	--
WEST VIRGINIA	--
WISCONSIN	--
WYOMING	Legislation proposed - repeal of doctrine
AMERICAN SAMOA	
GUAM	
PACIFIC TRUST	
PUERTO RICO	
VIRGIN ISLANDS	
TOTAL	

*See Comments.

ABOLITION OR MODIFICATION OF JOINT AND SEVERAL LIABILITY - Comments

CONNECTICUT
Retains state sovereign immunity; State Claims Commission hears and may approve claims under $5,000; municipal liability retained (except in limited circumstances).

DELAWARE
State waives immunity but mandates insurance coverage; retains sovereign immunity for local governmental immunities and provides a $300,000 cap per occurrence where immunity is waived (see §1515, Tit. 6).

INDIANA
Eliminated the concept of joint end several liability: abolished effective 1/1/85.

IOWA
Generelly, there is joint and several liebility, but not with respect to defendants who are found to bear less then 50% of the total fault assigned to all perties.

LOUISIANA
Generelly, there is joint and several liability but not where defendant's fault is less then that of the plaintiff, in which case defendant is liable only to the extent of own feult.

MAINE
$300,000 cap per occurrence where immunity is waived.

MINNESOTA
Generally, joint and several liability, but if pleintiff's negligence is greater then that of any of several defendants, plaintiff cannot recover at all from that defendant.

NEVADA
Generally, joint and several liability except that a defendant who is less at fault than the plaintiff is liable only for that portion of the judgment which represents the percentage of negligence attributable to him.

NEW HAMPSHIRE
Eliminated the concept of joint and several liability. $100,000 cap per occurrence where immunity is waived.

NEW YORK
See Civil Practice Law and Rules (CPLR) 1404.

OHIO
Based upon computer searches of Ohio court decisions and statutes, this state still <u>has</u> instances of joint end several liability (see memo R-11 '-2395, which still is generally correct. However, the effect of the doctrine may be mitigated in some cases by Ohio's contributions among joint tortfeasors statutes (R.C. 2307.31-2307.32, see memo's appendices) and possibly by the comparative negligence statute (R.C. 2315.19). See also these cases: <u>Barry v. Schorling</u>, 2 Ohio App.3d 110 (1981); <u>Lattea v. Akron</u>, 9 Ohio App.3d 118 (1982); and <u>National Mutl. Ins. Co. v. Whitmer</u>, 70 Ohio St.2d 149 (1982).

ABOLITION OR MODIFICATION OF JOINT AND SEVERAL LIABILITY - Comments

OHIO, Cont'd

Recent legislation places a cap of $250,000 per person and $500,000 per occurrence, as well as a limitation on recovery for pain and suffering to cases of wrongful death or substantial permanent disability/disfigurement and $5,000 in medical expenses.

OKLAHOMA

No joint and several liability except where damages cannot be apportioned.

PENNSYLVANIA

Generally, joint and several liability except where plaintiff's fault is greater than a defendant's in which case the defendant is liable only for the percantage attributable to him.

RHODE ISLAND

$50,000 cap per occurrence where immunity is waived.

TEXAS

Generally, joint and several liability, but if plaintiff's negligence is greater than that of any of several defendants, plaintiff cannot recover at all from that defendant.

ABOLITION OR MODIFICATION OF COLLATERAL SOURCE DOCTRINE

ALABAMA	--
ALASKA	A.S. 09.55.548 (medical malpractice only)
ARIZONA	A.R.S. 12-565 (medical malpractice only)
ARKANSAS	--
CALIFORNIA	--
COLORADO	--
CONNECTICUT	P.A. 85-574
DELAWARE	--
FLORIDA	§672.7372 Fla. Stat. (automobile cases only)
GEORGIA	--
HAWAII	--
IDAHO	--
ILLINOIS	--
INDIANA	--
IOWA	--
KANSAS	--
KENTUCKY	--
LOUISIANA	--
MAINE	17-A MRSA §1322
MARYLAND	--
MASSACHUSETTS *	Yes
MICHIGAN	--
MINNESOTA	--
MISSISSIPPI	--
MISSOURI	--
MONTANA	--
NEBRASKA	--
NEVADA	N.R.S. 42.020 (limited in scope)
NEW HAMPSHIRE	--
NEW JERSEY *	N.J.S.A. 59:9-2
NEW MEXICO	--
NEW YORK *	Yes
NORTH CAROLINA	N.C. Gen. Stat. §8C-1, Rule 411
NORTH DAKOTA	--
OHIO *	--
OKLAHOMA	510.5 (1984), §153(D)
OREGON *	Yes
PENNSYLVANIA	42 Pa.C.S.A. §8553(d)
RHODE ISLAND	R I. Gen. Laws §9-19-34 (medical malpractice only)
SOUTH CAROLINA	--
SOUTH DAKOTA	--
TENNESSEE	--
TEXAS	--
UTAH	--
VERMONT	--
VIRGINIA	--
WASHINGTON	--
WEST VIRGINIA	--
WISCONSIN	--
WYOMING	--
AMERICAN SAMOA	
GUAM	
PACIFIC TRUST	
PUERTO RICO	
VIRGIN ISLANDS	
TOTAL	

* See Comments.

ABOLITION OR MODIFICATION OF COLLATERAL SOURCE DOCTRINE - Comments

MASSACHUSETTS
Domenic Corsetti, et al. v. The Stone Company, et al., 396 Mass. 1 (September 19, 1985). Admission of collateral source evidence is a matter for the Trial Judge. Evidence may be admitted to contradict plaintiff's testimony that his injury had caused him loss of money and where relevant to his motive for staying out of work.

NEW JERSEY
Gives public entities a credit for all collateral sources except for life insurance.

NEW YORK
Civil Practice Law & Rules 4545 - actions for medical and dental malpractice and certain actions against public employers.

OHIO
Based upon computer searches of Ohio court decisions and statutes, Ohio still generally follows this doctrine. See Shearer v. Motorists Mut. Ins. Co., 53 Ohio St.2d 1 (1978); Suchy v. Moore, 29 Ohio St.2d 99 (1972); and Pryor v. Webber, 23 Ohio St.2d 104 (1970). See also Evidence Rule 411 (inadmissibility of liability insurance information). However, in the recent political subdivision sovereign immunity act, there is a requirement of the disclosure and deduction of insurance and other collateral benefit sources (R.C. 2744.05(B)); additionally, R.C. 2305.27 relates to limited consideration of collateral benefits in "medical claims" cases; and, finally, recoveries against the State of Ohio in the Court of Claims must be reduced by insurance, disability awards, and other collateral benefits (R.C. 2743.02(D)).

OREGON
1) O.R.S. 18.500-18.530 (advance payment by or on behalf of tortfeasor)
2) O.R.S. 743.792(7) (uninsured motorist coverage in motor vehicle liability policy)
3) O.R.S. 743.800-743.835 (Personal injury benefits protection in motor vehicle liability policy)

ESTABLISHMENT OF PREJUDGMENT INTEREST ACCRUAL PRINCIPLE 5

ALABAMA	--
ALASKA *	A.S. 09.50.280; A.S. 45.45.010
ARIZONA	--
ARKANSAS	--
CALIFORNIA	--
COLORADO	--
CONNECTICUT	C.S.G.A. §52-192a
DELAWARE	--
FLORIDA	--
GEORGIA	--
HAWAII *	H.R. Stat. §636-16; see also H.R. Stat. §661-68
IDAHO	I.C. §28-22-104
ILLINOIS	--
INDIANA	--
IOWA	--
KANSAS	K.S.A. 16-205
KENTUCKY	--
LOUISIANA	La. Civil Code Art. 2924;La. Rev. Stat. 13:5112 and 13:5117
MAINE	14 MRSA §§1427-1430
MARYLAND	--
MASSACHUSETTS	--
MICHIGAN	--
MINNESOTA	Minn. Stat. §549.09 (Supp. 1985)
MISSISSIPPI	--
MISSOURI	--
MONTANA	Chapter 523. L. 1985 (27-1-210, MCA)
NEBRASKA	--
NEVADA	N.R.S. 17.130(2)
NEW HAMPSHIRE	--
NEW JERSEY *	Rule of Court - R. 4:42-11
NEW MEXICO	--
NEW YORK *	Civil Practice Law & Rules 5001, 5002, 5003
NORTH CAROLINA	N.C.Gen. Stat. §24-5
NORTH DAKOTA *	Yes
OHIO *	Yes
OKLAHOMA	12 O.S. Supp. 1985, §727; 36 O.S. Supp. 1985, §3629
OREGON	--
PENNSYLVANIA	Pa. R.C.P. 238
RHODE ISLAND	R.I. Gen. Laws §9-21-10
SOUTH CAROLINA	§34-31-20, S.C.R.S.
SOUTH DAKOTA	S.D.C.L. §21-1-11
TENNESSEE	--
TEXAS	--
UTAH	--
VERMONT	--
VIRGINIA	--
WASHINGTON	--
WEST VIRGINIA	--
WISCONSIN *	--
WYOMING	
AMERICAN SAMOA	
GUAM	
PACIFIC TRUST	
PUERTO RICO	
VIRGIN ISLANDS	
TOTAL	

* See Comments.

ESTABLISHMENT OF PREJUDGMENT INTEREST ACCRUAL PRINCIPLE - Comments

ALASKA
<u>State v. Phillips</u>, 470 P.2d 266 (1970)

HAWAII
Prejudgment interest may accrue as early as date of injury.
H.R.S. §662-2 (no prejudgment interest against state).

NEW JERSEY
Public entities do not pay prejudgment interest. N.J.S.A. 59:9-2.

NEW YORK
Interest in tort actions, except certain actions dealing with property, is available from verdict, report or decision to judgment and upon judgment.

NORTH DAKOTA
North Dakota Century Code §32-03-04 only applies to situations where damages are certain or capable of being made certain by calculation and generally applies to contract actions. However, it is conceivable that if the plaintiff could show damages with some degree of certainty, i.e., legal malpractice, negligent bailment, etc., this statute would be applicable in a negligence action. However, North Dakota has not expressly adopted the prejudgment interest accrual principle.

WISCONSIN
Provisions for interest accrual from date of settlement offer - see §807.01 Stats.

ESTABLISHMENT OF LIMITS ON NON-ECONOMIC DAMAGES

ALABAMA	--
ALASKA	--
ARIZONA	--
ARKANSAS	--
CALIFORNIA	Cal. Civ. Code §3333.2 (West. Supp. 1984)
COLORADO	--
CONNECTICUT	--
DELAWARE	--
FLORIDA	-- Legislation proposed.
GEORGIA	--
HAWAII	Hawaii Rev. Stat. Ch. 294 ("no fault" statute for autos and vehicles)
IDAHO	--
ILLINOIS	--
INDIANA	--
IOWA	--
KANSAS	--
KENTUCKY	--
LOUISIANA *	La. Rev. Stats. 13:5106; 13:5149 (punitive damages) (cont'd in comments
MAINE	18-A M.R.S.A. §2-804 (wrongful death action)
MARYLAND	--
MASSACHUSETTS *	Yes
MICHIGAN	--
MINNESOTA	--
MISSISSIPPI	--
MISSOURI	§§383.075 to 383.083, R.S.Mo. Supp. 1985 (H.B. 657 and 337)
MONTANA *	Chapter 507, L. 1985 (27-1-221, MCA)
NEBRASKA	--
NEVADA	--
NEW HAMPSHIRE	--
NEW JERSEY *	--
NEW MEXICO	--
NEW YORK *	Yes
NORTH CAROLINA	--
NORTH DAKOTA	--
OHIO *	R.C. 2744.05(C); R.C. 2307.43
OKLAHOMA	--
OREGON	--
PENNSYLVANIA *	42 Pa.C.S.A. §8528
RHODE ISLAND	--
SOUTH CAROLINA	--
SOUTH DAKOTA	S.D.C.L. §21-3-11
TENNESSEE	T.C.A. §147-14-123 (1984) (as to claims against state only)
TEXAS	Article 4590, Section 11.02, Revised Statutes
UTAH	--
VERMONT	--
VIRGINIA	--
WASHINGTON	--
WEST VIRGINIA	--
WISCONSIN *	Sec. 893.82(6)
WYOMING *	--
AMERICAN SAMOA	
GUAM	
PACIFIC TRUST	
PUERTO RICO	
VIRGIN ISLANDS	
TOTAL	

* See Comments.

ESTABLISHMENT OF LIMITS ON NON-ECONOMIC DAMAGES - Comments

LOUISIANA
(Cont'd) La. Rev. Stats. 40:1299.39; 40·1299.42 and 40:1299.43.

MASSACHUSETTS
Limits under Tort Claims Act $100,000: in Highway Defect Cases as to Commonwealth of Massachusetts, $5,000; and on malpractice cases considered as to total damages.

MONTANA
Generally, statute providing immunity for all non-economic damages was overturned by state Supreme Court (1983). However, this amendment was passed in 1985 session in response to the increasing number of wrongful termination cases being filed, partially as a result of the Montana Supreme Court's recognition of a number of causes of action related to termination of employment.

NEW JERSEY
No limitations except for claims under wrongful death statute. N.J.S.A. 2A-31-1 et seq.

NEW YORK
Limitation of exclusion of damages only in the case of workers' compensation (Workers' Compensation Law Section 11) and no-fault automobile insurance (Insurance Law Section 5104).

OHIO
No statute applicable to all tort cases, but in the recent political subdivision sovereign immunity act, there is a $250,000 cap on non-economic damages in civil actions other than wrongful death actions (R.C. 2744.05(C)). The Ohio Constitution prohibits caps in wrongful death cases (Article I, Section 19A). There also is a $200,000 cap in medical malpractice (nondeath) cases, which may apply to economic as well as non-economic damages and may be subject to constitutional challenge (R.C. 2307.43).

PENNSYLVANIA
Subject to attack on constitutional grounds; issue in state Supreme Court; Lyles v. Philadelphia.

TEXAS
Medical malpractice found unconstitutional in Baptist Hospital of Southeast Texas v. Baber, 672 S.W.2d 296 (Tex. App. Beaumont 1984, writ granted).

WISCONSIN
Applies only to limits of $250,000 per claimant for each state employee sued and denial of punitive damages.

WYOMING
Proposal to eliminate constitutional prohibition (Article X, Section 4, Wyoming Constitution.

ESTABLISHMENT OF PROVISIONS OF STRUCTURED AWARDS 7

ALABAMA	Ala. Code §6-5-486 (1975)
ALASKA	A.S. 09.55.548 (medical malpractice only)
ARIZONA	--
ARKANSAS	Ark. Stat. Ann. §34.2619 (Supp. 1983)
CALIFORNIA	Cal. Civ. Proc. Code §667.7 (West 1980)
COLORADO	--
CONNECTICUT	--
DELAWARE	Del. Code Ann. Tit. 18 §6864 (Supp. 1984)
FLORIDA *	§768.57 Fla. Stat. (1985)
GEORGIA	--
HAWAII *	--
IDAHO	--
ILLINOIS	Public Act 84-7, Ill. Rev. Stat., Ch. 110, Par. 2-611.1
INDIANA *	Yes
IOWA	--
KANSAS	Kan. Stat. Ann. §60-2609 (1983)
KENTUCKY	--
LOUISIANA	La. Rev. Stats. 13:5114 (Act No. 45) 450
MAINE	--
MARYLAND	--
MASSACHUSETTS	--
MICHIGAN	--
MINNESOTA	Minn. Stat. 3.736 et seq.
MISSISSIPPI	--
MISSOURI	--
MONTANA *	Yes
NEBRASKA	--
NEVADA	--
NEW HAMPSHIRE	--
NEW JERSEY	--
NEW MEXICO	--
NEW YORK *	Civil Practice Law & Rules 50-A
NORTH CAROLINA	--
NORTH DAKOTA	--
OHIO *	--
OKLAHOMA	--
OREGON	--
PENNSYLVANIA	--
RHODE ISLAND	R.I. Gen. Laws §28-33-25 (workers' compensation only)
SOUTH CAROLINA *	--
SOUTH DAKOTA *	--
TENNESSEE *	Tenn. Code Ann. §7-51-202 (1985); §9-8-307 (1985 Supp.) (see comments
TEXAS	--
UTAH	--
VERMONT	--
VIRGINIA	--
WASHINGTON	--
WEST VIRGINIA	--
WISCONSIN	--
WYOMING	-- Proposed legislation
AMERICAN SAMOA	
GUAM	
PACIFIC TRUST	
PUERTO RICO	
VIRGIN ISLANDS	
TOTAL	

* See Comments.

ESTABLISHMENT OF PROVISIONS OF STRUCTURED AWARDS - Comments

FLORIDA
Structured awards for future losses in excess of $500,000 against health care providers.

HAWAII
Bills introduced in last session were rejected. Will be introduced again in 1986 session.

INDIANA
Permitted by custom and practice, not by statute or case law.

MONTANA
Workers' Compensation Law specifically provides for structured awards in 39-71-741, MCA (Chapter 471, L. 1985). No other statutory provisions, but method is commonly judicially applied in civil law cases.

NEW YORK
Only in medical and dental malpractice cases.

OHIO
No bill has been passed on the subject, but proposals are being considered. In Ohio's courts, structured settlements/awards have occurred without legislation on the books. See, however, the installment payments provisions in the recent political subdivision sovereign immunity act (R.C. 2744.06(B) and (C)).

SOUTH CAROLINA
Structured settlements are permitted by custom and practice, not by legislation.

SOUTH DAKOTA
Proposals for 1986 session similar to California statute regarding periodic payments for medical malpractice awards.

PENALTIES FOR FILING FRIVOLOUS SUITS 8

ALABAMA	--
ALASKA	A.S. 09.55.536 (medical malpractice only)
ARIZONA	--
ARKANSAS	--
CALIFORNIA	--
COLORADO *	13-17-101 through 106. C.R.S. (1973 and 1985 Supp.) (see comments)
CONNECTICUT *	C.G.S.A. §§52-240a; 52-568
DELAWARE	--
FLORIDA *	§57.105 Fla. Stat.
GEORGIA	--
HAWAII	H.R. Stats., §§294-31; 607-14.5
IDAHO	I.R.C.P. Rule 54(e)
ILLINOIS	Public Act 84-7, Ill. Rev. Stat., Ch. 110, Par. 2-611.1
INDIANA	Ind. Code 34-4-16.5-19
IOWA	--
KANSAS	-- Statutory provisions are seldom used.
KENTUCKY	--
LOUISIANA *	Yes
MAINE	--
MARYLAND	--
MASSACHUSETTS	Mass. Gen. Laws Ch. 258, §11; Mass. Gen. Laws Ch. 231, §6F
MICHIGAN	--
MINNESOTA	Minn. Stat. 1984, §549.21
MISSISSIPPI *	-- See comments.
MISSOURI	§514.205, RSMo (S.B. 5, 1985)
MONTANA	--
NEBRASKA	--
NEVADA *	N.R.S. 18.010(2)
NEW HAMPSHIRE	--
NEW JERSEY	--
NEW MEXICO	--
NEW YORK	Civil Practice Law & Rules 8303-a
NORTH CAROLINA	N.C. Gen. Stat. §6-21.5
NORTH DAKOTA	N.D.C.C. §28-26-01
OHIO *	-- See comments.
OKLAHOMA	--
OREGON	--
PENNSYLVANIA	--
RHODE ISLAND	--
SOUTH CAROLINA *	--
SOUTH DAKOTA	-- Proposed for 1986 session
TENNESSEE	Tenn. Code. Ann. §27-1-122 (1980) (frivolous appeals)
TEXAS	Chapter 105, Civil Practice & Remedies Code
UTAH	--
VERMONT	--
VIRGINIA	--
WASHINGTON	--
WEST VIRGINIA	--
WISCONSIN *	§814.025 Stats.
WYOMING *	--
AMERICAN SAMOA	
GUAM	
PACIFIC TRUST	
PUERTO RICO	
VIRGIN ISLANDS	
TOTAL	

* See Comments.

PENALTIES FOR FILING FRIVOLOUS SUITS - Comments

COLORADO
24-10-110(s), C.R.S. (1973), S.B. 182 (1984) - Penalties for filing frivolous suits. State Court Administrator's Office conducted a survey of use of frivolous lawsuits and found that judges do not invoke frivolous lawsuit legislation very often. A major weakness in such legislation lies in the stipulation that it cannot be used if the lawsuit involves a question of fact. In particular, whenever a party can bring in an expert witness, the issues which he testifies about become issues of fact, and as a result the frivolous lawsuit legislation cannot be used even if the action is frivolous.

FLORIDA
Awarding attorneys' fees to prevailing party where "complete absence of justiciable issue of either law or fact."

LOUISIANA
La.R.S. 3:3605; R.S. 42:11; R.S. 46:1820; R.S. 49:146
Louisiana Code of Civil Procedure Articles 863, 864 and 2164

MISSISSIPPI
See Rule 11q of Mississippi Rules of Civil Procedure.

NEVADA
Amended (1985), allows recovery of attorneys' fees when complaint "was brought with reasonable ground."

NORTH CAROLINA
Attorneys' fees awarded if court finds absence of justiciable issue.

OHIO
Under the Ohio Business Opportunity Plans Law and Consumer Sales Practices Law, the penalty of an attorney's fees award is available for groundless, bad faith actions (R.C. 1334.09 and 1345.09). In tort cases in general, there does not appear to be a general frivolous suit/penalty statute. Appellate Rule 23, however, permits courts of appeals to impose attorney's fees and court costs as penalties in the case of frivolous appeals. Additionally, in connection with frivolous tort civil actions, common law remedies (such as malicious prosecution actions) might be available against former plaintiffs who filed frivolous suits, but Ohio is strict relative to malicious prosecution recoveries. See Clermont Environmental Reclamation Co. v. Hancock, 16 Ohio App.3d (1984).

The frivolous suit issue has arisen in the past in Ohio relative to medical malpractice cases (see memo R-112-2782). The question has at times been whether attorneys as well as their clients should be pursued for frivolous suits. No legislative enactments have resulted, but several years ago legislation was discussed that would have imposed attorney's fees/court costs penalties for filing frivolous civil actions or appeals. Finally, see the memo R-116-1327 relative to attorney's fees awards in Ohio; also bear in mind that, in Ohio, prevailing parties in civil actions generally are awarded court costs under Civil Rule 54(D).

SOUTH CAROLINA
Rules of Procedure No. 54 allows costs to be allocated to prevailing party.

PENALTIES FOR FILING FRIVOLOUS SUITS - Comments

WISCONSIN
This section is of limited value because findings by a court that en action is frivolous requires the court report the attorney filing the action to the bar association, and judges are reluctant to do so.

WYOMING
Rules Committee of the Supreme Court is considering adoption of Fed. Rules Cuv. Proc. Rule 11.

FOR GOVERNMENT EMPLOYEES AND OFFICIALS

ALABAMA	--
ALASKA	Yes
ARIZONA	A.R.S. 12-820 et seq. (modified 1984)
ARKANSAS	--
CALIFORNIA	--
COLORADO	24-10-118, C.R.S (1973 and 1985 Supp.)
CONNECTICUT	C.G.S.A. §§4-160; 4-165
DELAWARE	Del. Code Ann. Tit. 10 §4011
FLORIDA *	§768.28(9)(a), Fla. Stat.
GEORGIA	--
HAWAII	Haw. Rev. Stat. §26-35.5
IDAHO	I.C. §6-901 et seq.
ILLINOIS	Ill. Rev. Stat. 1983, Ch. 85, Par. 101-1 et seq.
INDIANA	Ind. Code 34-4-16.5-3 (limited immunity)
IOWA	--
KANSAS	K.S.A. 75-6101 et seq. (Tort Claims Act)
KENTUCKY	-- Common law in effect.
LOUISIANA *	Yes
MAINE	14 M.R.S.A. §8101 et seq. (Tort Claims Act)
MARYLAND	Yes
MASSACHUSETTS *	Yes
MICHIGAN	--
MINNESOTA	Minn. Stat. 3.736 et seq.
MISSISSIPPI	H.B. 983 (1985) §11-46-1 et seq.
MISSOURI *	§537.035 (1985 H.B. 357); State Legal Expense Fund (see comments)
MONTANA	Chapter 530, L. 1983 (2-9-305, MCA)
NEBRASKA	--
NEVADA	N.R.S. 41.032; 41.033
NEW HAMPSHIRE	--
NEW JERSEY	N.J.S.A. 59:1-1 et seq.
NEW MEXICO	--
NEW YORK	--
NORTH CAROLINA	--
NORTH DAKOTA	N.D.C.C. §32-12.1-03
OHIO *	R.C. 9.85, 9.86, 2743.02; 2744.03(A)(6)
OKLAHOMA *	Yes - see comments.
OREGON	O.R.S. 30.265
PENNSYLVANIA	Case law: Pine v. Synkonis et al.
RHODE ISLAND	R.I. Gen. Laws §§91-127; 5-34-34; 45-16-5
SOUTH CAROLINA *	--
SOUTH DAKOTA	S.D.C.L. §§21-32-17 and 18
TENNESSEE	T.C.A. §9-8-307(h)
TEXAS	--
UTAH	--
VERMONT	--
VIRGINIA	--
WASHINGTON	--
WEST VIRGINIA	--
WISCONSIN *	1985 Wisconsin Act 47, Section 4 (125.035)
WYOMING	
AMERICAN SAMOA	
GUAM	
PACIFIC TRUST	
PUERTO RICO	
VIRGIN ISLANDS	
TOTAL	

* See Comments.

ESTABLISHMENT OF IMMUNITY FOR GOVERNMENT EMPLOYEES AND OFFICIALS - Comments

FLORIDA
Provides for immunity for acts in scope of employment, unless acting in bad faith, with malicious purpose, or in manner exhibiting wanton and willful disregard of human rights, safety, or property.

LOUISIANA
Louisiana Revised Statutes 9:2798.1, 13:5108.1 and 13:5108.2, 29:23.1, 40:1299.39, 42:1441.1-1441.4. This list does not include special statutes covering specific officers and functions.

MASSACHUSETTS
Massachusetts General Laws, Chapter 258 (public employees)
Massachusetts General Laws, Chapter 33 (national guard)
Massachusetts General Laws, Chapter 111C, Section 14 (medics rendering assistance in emergencies)
Massachusetts General Laws, Chapter 119, Section 51A (social workers and other mandated reporters immune from suit for filing report of suspected child abuse)

MISSOURI
(Cont'd) §§105.711 to 105.726 (S.B. 275, 1983)

OHIO
1) For state employees, see qualified immunity provisions of R.C. 9.85, 9.86, and 2743.02.
2) For political subdivision employees, see the recent political subdivision sovereign immunity act (R.C. 2744.03(A)(6).

OKLAHOMA
1) 19 O.S. 1981, §371
2) 63 O.S., §683.14
3) 57 O.S., §553
4) 11 O.S., §§29-108 and 37-121
5) 22 O.S., §371
6) 11 O.S., §23-104

SOUTH CAROLINA
McCall v. Batson, Supra, contains some language on the subject of immunity for government officials. H.B. 2266 (pending) contains provisions on this issue.

WISCONSIN
Statute was recently enacted in response to Appellate Court decisions holding liquor dispensers liable.

MODIFICATION OF DRAM SHOP LAWS

ALABAMA	--
ALASKA *	A.S. 04.21.020
ARIZONA	No statute; found in case law.
ARKANSAS	--
CALIFORNIA	--
COLORADO	--
CONNECTICUT	--
DELAWARE	--
FLORIDA *	768.125 Fla. Stat.
GEORGIA	--
HAWAII	--
IDAHO	--
ILLINOIS	Ill. Rev. Stat. 1983, Ch. 43, Par. 135
INDIANA	--
IOWA	--
KANSAS	--
KENTUCKY	--
LOUISIANA	--
MAINE *	17 M.R.S.A. §2002
MARYLAND	--
MASSACHUSETTS	--
MICHIGAN	--
MINNESOTA *	Laws of Minnesota 1985, Ch. 309, §12 and 13
MISSISSIPPI	--
MISSOURI	§537.053 (S.B. 345)
MONTANA *	--
NEBRASKA	--
NEVADA *	--
NEW HAMPSHIRE	--
NEW JERSEY *	--
NEW MEXICO	§41-11-1 N.M.S.A. (1978)
NEW YORK *	General obligations
NORTH CAROLINA	N.C. Gen. Stat. §18-B-305 (1983)
NORTH DAKOTA *	--
OHIO *	R.C. Chapter 4399
OKLAHOMA	--
OREGON	O.R.S. 30.950, 30.960
PENNSYLVANIA	--
RHODE ISLAND	--
SOUTH CAROLINA *	
SOUTH DAKOTA *	S.D.C.L. §§35-11-1 and 35-6-27; 35-4-78; 35-6-27; 35-11-2
TENNESSEE	Yes
TEXAS	--
UTAH	--
VERMONT	--
VIRGINIA	--
WASHINGTON	--
WEST VIRGINIA	--
WISCONSIN	--
WYOMING	W.S. 12-8-301 (1985)
AMERICAN SAMOA	
GUAM	
PACIFIC TRUST	
PUERTO RICO	
VIRGIN ISLANDS	
TOTAL	

* See Comments.

MODIFICATION OF DRAM SHOP LAWS - Comments

ALASKA
Liability of liquor licensee only for "criminal negligence" (1983)

FLORIDA
Limits liability to sale of alcohol to minors or knowingly to persons addicted to use of alcoholic beverages.

MAINE
Reduce liquor liability.

MINNESOTA
Compare: Minn. Stat. §340.95 (1984) and Minn. Stat. §340A.801 (Supp. 1985)

MONTANA
An unsuccessful attempt was made in 1985 (H.B. 395).

NEVADA
"Dram shop" laws are not recognized in Nevada.

NEW JERSEY
Proposed bill to limit liability of bars and retail liquor establishments for injuries to inebriated persons. Their liability to third parties injured by drunk persons would remain unchanged.

NEW YORK
No substantial modification of dram shop law in recent years; 1983 law cited above added coverage to persons under the legal drinking age.

NORTH DAKOTA
No change, but citation for dram shop laws: N.D.C.C. §5-01-06

OHIO
See R.C. Chapter 4399; it is a limited law. A recently introduced bill, H.B. 733 of the 116th General Assembly, would increase civil liability (R.C. 4399.18); H.B. 488 also relates to the subject.

SOUTH CAROLINA
Christiansen v. Campbell, (1985), 328 S.E.2d 351, recognized civil liability of seller of alcoholic beverage who sells to intoxicated person in violation of penal statutes prohibiting such sales. H.B. 2802 (pending) pertains to this issue.

SOUTH DAKOTA
Abrogation of dram shop laws.

MODIFIED STATUTE OF LIMITATIONS

ALABAMA *	Yes
ALASKA	--
ARIZONA	--
ARKANSAS	--
CALIFORNIA	--
COLORADO	--
CONNECTICUT	§§52-577a; 52-577b and 52-577c; P.A. 84-407; P.A. 84-287
DELAWARE	--
FLORIDA *	§95.11(4), F.S., providing 2 years from discovery (cont'd in comments)
GEORGIA	--
HAWAII	--
IDAHO	Limitations Tort Claims Act revised 1985, I.C. 6-901 et seq.
ILLINOIS *	--
INDIANA	Ind. Code 34-1-1-2
IOWA	--
KANSAS	K.S.A. 60-501 et seq.
KENTUCKY	--
LOUISIANA	--
MAINE *	14 M.R.S.A. §§752-A (design professionals), (cont'd in comments)
MARYLAND	Courts & Judicial Proceedings (CJ) §5-109 (actions against physicians)
MASSACHUSETTS	--
MICHIGAN	--
MINNESOTA	--
MISSISSIPPI	H.B. 63 (1985)
MISSOURI *	§516.140 (H.B. 225, 1985); §516.030 (1983, S.B.44 & 45); (see comments)
MONTANA	--
NEBRASKA	--
NEVADA	N.R.S. 41A.097 (regarding health care providers)
NEW HAMPSHIRE	
NEW JERSEY *	See comments.
NEW MEXICO	--
NEW YORK	C.P.L.R., §214-a; medical or dental malpractice
NORTH CAROLINA *	--
NORTH DAKOTA	N.D.C.C. Ch. 28-01
OHIO *	
OKLAHOMA	510.S.1984 §156(B)
OREGON *	O.R.S. 30.275
PENNSYLVANIA	Yes
RHODE ISLAND	--
SOUTH CAROLINA *	Section 15-3-545
SOUTH DAKOTA	Chapters 15-2 and 15-2a
TENNESSEE	T.C.A. §29-26-116 (1980) (medical malpractice)
TEXAS *	§16.008; Article 4590, §10.011
UTAH	--
VERMONT	--
VIRGINIA	--
WASHINGTON	--
WEST VIRGINIA	--
WISCONSIN	--
WYOMING	W.S. 1-3-107 (1976)
AMERICAN SAMOA	
GUAM	
PACIFIC TRUST	
PUERTO RICO	
VIRGIN ISLANDS	
TOTAL	

* See Comments.

MODIFIED STATUTE OF LIMITATIONS - Comments

ALABAMA
Statute of limitations in certain civil lawsuits and workers' compensation were increased as part of a workers' compensation compromise.
ACT 85-39)
ACT 85-41) 1984 2nd Special Session

FLORIDA
(Cont'd) not to exceed four years for medical malpractice, two years for professional malpractice, two years for wrongful death. Generally, four years for torts (§95.11(3) F.S.).

ILLINOIS
See, generally, Ill. Rev. Stat. 1983, Ch. 110, Par. 13-101.

MAINE
(Cont'd) 752-B (ski areas); 752-C (sexual acts); 753 (doctors and lawyers).

MISSOURI
(Cont'd) §516.170 (S.B. 44 & 45, 1983); §516.350 (S.B. 468, 1982).

NEW JERSEY
No, except that a claimant against a public entity must file a notice of claim within 90 days of the accrual of his cause of action.

NORTH CAROLINA
See N.C. Gen. Stat. §1-15(c) (1983) (malpractice).

OHIO
See R.C. 2743.16 (two years generally against the state); R.C. 2744.04 (two years generally against political subdivisions); R.C. 2305.11 (medical malpractice actions precluded four years after act or omission occurred, despite general statute of limitations of one year after the cause of action arose (discovery rule)); and 2305.131 (a statute of repose relative to defective and unsafe real property improvements).

OREGON
Established a two-year limitation for filing claims against the state or state employees.

SOUTH CAROLINA
Medical malpractice only; S. 153 providing for architects' limitation on liability is pending.

TEXAS
Neagle v. Nelson, 678 S.W.2d 918 (Tex. 1984); Nelson v. Krusen, 685 S.W.2d 11

LIMITATIONS ON ATTORNEY CONTINGENCY FEES

ALABAMA	--
ALASKA	--
ARIZONA	Ariz. Rev. Stat. Ann. §12-568 (1982)
ARKANSAS	--
CALIFORNIA	Cal. Bus. & Prof. Code §6146 (West. Supp. 1984)
COLORADO	--
CONNECTICUT	--
DELAWARE	Del. Code Ann. Tit. 18 §6865 (Supp. 1984)
FLORIDA *	Suits against state agencies §768.28(8) Fla Stat.
GEORGIA	--
HAWAII *	Yes
IDAHO	Idaho Code §39-4213 (1976)
ILLINOIS	Public Act 84-7, Ill. Rev. Stat., Ch. 110
INDIANA	Ind. Code Ann. §16-9.5-5-1 Par. 2-611.1
IOWA	Iowa Code Ann. §147.138 (West. Supp. 1984-85)
KANSAS	Kan. Stat. Ann. §7-1216 (1982)
KENTUCKY	--
LOUISIANA	--
MAINE	--
MARYLAND *	Yes
MASSACHUSETTS *	--
MICHIGAN	--
MINNESOTA	--
MISSISSIPPI	--
MISSOURI	--
MONTANA	--
NEBRASKA	Neb. Rev. Stat. §44-2834 (1978)
NEVADA	--
NEW HAMPSHIRE	--
NEW JERSEY	Regulated by Supreme Court R. 1:21-7
NEW MEXICO	--
NEW YORK	Judiciary Law 474-a
NORTH CAROLINA	--
NORTH DAKOTA	--
OHIO *	--
OKLAHOMA *	Yes
OREGON *	O.R.S. 752.150 (limited to medical, surgical, dental treatment,
PENNSYLVANIA	--
RHODE ISLAND	--
SOUTH CAROLINA	--
SOUTH DAKOTA	-- Proposal for 1986 session
TENNESSEE	T.C.A. §29-26-120 (1980) (medical malpractice)
TEXAS	--
UTAH	--
VERMONT	--
VIRGINIA	--
WASHINGTON	--
WEST VIRGINIA	--
WISCONSIN	--
WYOMING	-- (limitations by Wyoming Supreme Court, 1977)
AMERICAN SAMOA	
GUAM	
PACIFIC TRUST	
PUERTO RICO	
VIRGIN ISLANDS	
TOTAL	

* See Comments.

LIMITATIONS ON ATTORNEY CONTINGENCY FEES - Comments

FLORIDA
Also Section 768.575, F.S., provides guidelines for reasonable fees, including percentage of recovery.

HAWAII
Hawaii Revised Statutes, Section 671-2 (applies only to medical torts and limits contingent fees to a "reasonable amount as approved by a court of competent jurisdiction").

MARYLAND
Partial (for suits against state government).

MASSACHUSETTS
Except in cases of Industrial Accident Board (20%) end victims of violent crime (15%).

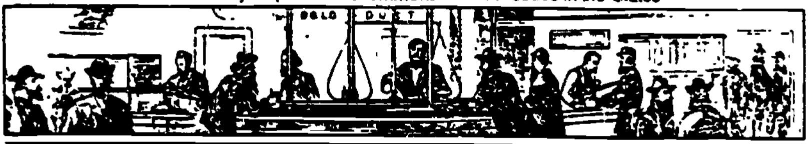
OHIO
There is no general statutory limitation on chargeable attorney contingency or hourly fees in tort cases; in some civil cases, attorney's fees may be subject to regulation (e.g., workers' compensation cases) or to court approval. However, attorney's fees generally are required to be reasonable under the Code of Professional Responsibility applicable to Ohio's attorneys.

A recently introduced bill, H.B. 694 of the 116th General Assembly, would limit recoverable or payable attorney's fees in civil actions against political subdivisions of Ohio.

OKLAHOMA
Oklahoma Bar Association Advisory Opinion #28 (fee limitation of 50% or less).

OREGON
(Cont'd) omission, operations.

A Bi-Monthly Report on Government Finance Issues in the States



THE FISCAL LETTER

An Information Service of the National Conference of State Legislatures — Earl S Mackey, Executive Director

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LIABILITY INSURANCE: WRESTLING WITH A THORNY ISSUE

In the past year, states, local governments, and private businesses have found it increasingly difficult to obtain or afford liability insurance. Cities, states, physicians, and hospitals, among others, have seen dramatic increases in their liability insurance rates. North Dakota estimates that liability coverage for its Department of Human Resources will increase 219 percent, from $453,346 to $1,446,133 during the 1985-87 biennium, as compared to the previous biennium. Specialists in some parts of the country are seeing their medical malpractice premiums climb to more than $50,000 annually.

Small businesses, long distance truckers, directors and officers of corporations, owners of gasoline stations, grain elevator operators, and colleges and universities are examples of others facing huge increases in liability insurance premiums. Child care centers are finding it difficult to buy insurance in light of an increase in sexual abuse claims. And many waste dump operators cannot find a company to insure them--a serious problem, as insurance is usually a license requirement.

Roots of the Problem

Several factors in combination have led to today's "crisis" in liability insurance affordability and availability. While there is some difference of opinion on the extent to which each contributes to the problem, the following are the most frequently cited factors:

- A drop in the return on investments made by insurance companies. In the late 1970s, when interest rates were high, insurers eagerly wrote policies and invested the premiums. The competition for business

(Continued on page 2)

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LIABILITY INSURANCE (Continued)

drove down the price of insurance, but the claims continued. As the return on investment dropped with the rate of inflation, losses in the insurance industry have mounted. In the past two years, companies lost more than in the previous 25 years.

- Excessive damage awards. A small percentage of cases account for the bulk of dollar payouts. Whereas settlements for more than $1 million were rare just five years ago, such high settlements are somewhat more common today. For example, a swimmer who became paralyzed after diving in the surf at a town beach won a $6 million judgment against the city of Newport Beach, California, earlier this year. Large awards for pain and suffering often result in high settlements. Some also argue that the collateral source rule results in excessive awards. This rule forbids the introduction of evidence that the plaintiff is already receiving compensation from other sources. Thus, a patient may receive compensation from more than one source for a single element of loss, such as medical expenses.

- Increased uncertainty about the number and size of future claims and awards. In recent years, insurers have seen more and more plaintiffs successfully sue either for events which took place many years ago, whose harmful effects are only now coming to light (e.g. leaking toxic waste sites), or for which claims were once virtually unheard of (e.g., sexual abuse claims against operators of child care centers). As insurers find it increasingly difficult to accurately predict the nature of their clients' liability, they are more and more reluctant to assume such risks.

- High administrative costs. Estimates are that only 28-40 cents of each medical malpractice premium dollar ultimately goes to injured parties. Administration, claims evaluation, and litigation costs, including plaintiff attorneys' contingent fees and defense attorneys' hourly fees, absorb more than one-half of each medical malpractice insurance premium dollar. Similar figures apply for much of the liability insurance market.

Several additional factors have exacerbated the liability insurance problem for state and local governments:

- The doctrine of joint and several liability. This doctrine allows a plaintiff to sue any or all of the possible defendants for the full amount of his damage. Although a plaintiff cannot collect more than his legally determined damages, he may collect it from the defendant with the most resources or the "deepest pocket," irrespective of that defendant's degree of fault. This rule often works against governments because they are always considered deep pocket defendants. For example, a city which is found to be 10 percent at fault in an accident may have to pay all or most of the damages if the other defendants have no resources.

- Loss of sovereign immunity. Under the doctrine of sovereign immunity, which is derived from an ancient English common law, citizens cannot sue their own government. This doctrine has been eroded substantially over the years as a result of federal and state legislative and judicial actions.

Potential Solutions

Proposed strategies for dealing with the liability insurance problem fall into three categories: 1) those that involve tort law revisions, 2) those that require administrative reforms; and 3) those that may be taken independently by the states. Table 1 summarizes categories of insurance liability bills likely to be introduced in upcoming legislative sessions.

Under the heading of tort law revisions, the following proposals are frequently mentioned:

- Amend the joint and several liability rule to limit the liability of deep pocket defendants where their percentage of fault is relatively minor.

- Change the collateral source rule to allow evidence to be introduced that the plaintiff has received compensation from other sources.

- Establish pretrial panels to encourage early settlement and weed out frivolous claims.

- Place limits on the amounts recoverable, these limits may be placed on the total amount of an award or only on the amounts recoverable for non-economic losses, such as pain and suffering, disfigurement, impairment of quality of life, or punitive damages.

- Permit courts to allow structured damages--damages paid in installments throughout the plaintiff's period of disability, up to a lifetime--in lieu of lump sum awards.

- Regulate the contingent fee arrangements of plaintiff's attorneys.

Administrative reforms may include the following

- Require insurance companies and self-insurers to submit basic information on their liability experience to give states a better understanding of the frequency and severity of claims and the adequacy of premiums, as well as provide feedback on the effect of enacted legislation.

(Text continued on page 4)

TABLE 1

BILLS DEALING WITH LIABILITY INSURANCE LIKELY TO BE
INTRODUCED IN UPCOMING LEGISLATIVE SESSIONS*
November 1985

STATE	TORT LAW REVISION: Joint/Several Liability	Collateral Source	Prejudgment Interest	Caps on Damages	Structured Awards	Frivolous Suits	Sovereign Immunity	INSURANCE REGULATION: Insolvency/Guaranty Fund	Administrative Action to Promote Access	NOTES
Alabama										
Alaska	•	•	•	•	•	•	•			May consider insurance code revision.
Arizona	•	•		•	•			•		
Arkansas										Created special commission on property/casualty insurance.
California	•	•	•	•	•	•	•	•		
Colorado	•	•	•	•	•	•	•	•		
Connecticut										Abolished collateral source rule for MedMal claims (1986).
Delaware										State has authority for joint underwriting.
Florida	•				•				•	
Georgia**										
Hawaii				•		•		•		Insurance code scheduled for revision in 1987.
Idaho**										
Illinois**									•	May propose citizen advocate for insurance board.
Indiana										
Iowa	•	•	•	•	•	•	•			
Kansas										Capped punitive damages in MedMal claims (1986).
Kentucky						•				
Louisiana										Awaiting court test of cap on damage awards.
Maine				•						
Maryland										Created MedMal and liability insurance task forces.
Massachusetts				•						
Michigan	•	•	•			•				
Minnesota								•		
Mississippi										
Missouri										
Montana				•						
Nebraska**								•		
Nevada										Insurance insolvency statute enacted (1985)
New Hampshire										
New Jersey**									•	Moratorium on insurance cancellations in place
New Mexico										
New York	•									
North Carolina**								•		
North Dakota	•									
Ohio							•		•	Order prohibiting mid-term insurance cancellations
Oklahoma										
Oregon	•								•	May prohibit mid-term cancellation or rate increase
Pennsylvania										Currently reviewing insurance investment rules.
Rhode Island	•			•			•			
South Carolina	•		•	•			•			
South Dakota	•	•		•	•					
Tennessee										
Texas**										
Utah										Major rewrite of insurance code (1985)
Vermont										
Virginia		•					•			Insurance code may be recodified
Washington	•	•	•		•			•		
West Virginia		•		•	•					
Wisconsin				•						
Wyoming**										Bill may give increased authority to insurance Commissioner

* Based on a survey of state legislatures conducted by the National Conference of State Legislatures, November 1985.

**Study of possible tort law revisions in progress

Definitions

Insolvency/Guaranty Fund: actions taken to protect claimants from insolvency failure of insurance companies
MedMal: medical malpractice
Prejudgment Interest: assessment of interest as of the date of the filing of the claim.
Structured Awards: allows defendant to pay a claim over a period of time

LIABILITY INSURANCE (Conclusion)

- Prohibit midterm cancellations of policies unless the risk has demonstrably increased and direct companies to give policyholders more notice of intent to cancel.

- Allow insurance companies to write policies on a "claims made" rather than on an "occurrence" basis. Occurrence-based insurance holds the insurance company responsible for claims resulting from treatment rendered during the coverage period, regardless of when the claim was filed. Claims-made based insurance holds insurers responsible for claims filed only during the coverage year.

Independent actions that states may take to control their liability insurance costs include:

- Reassert, wholly or partially, sovereign/government immunity and extend this immunity to local governments.

- Improve risk management in order to reduce the likelihood of claims.

- Self-insure instead of buying liability insurance from third parties.

<u>An Example from Medical Malpractice Insurance</u>

A crisis in the availability of malpractice insurance inspired reform legislation in almost every state ten years ago. Many of the strategies outlined above were enacted at that time to deal with the crisis. These reforms were meant to encourage settlements before trial, to limit recoveries, to improve quality of care, and to alter the legal process.

State legislation was effective in solving malpractice availability problems, but the effect of tort reforms on claims and recoveries is far less clear.

Economist Frank Sloan of Vanderbilt University, who analyzed the reforms' impact on malpractice Premiums, concluded that "the empirical results of this study give no indication that individual state legislative actions, or actions taken collectively, have had their intended effects on premiums."

Dr. Patricia Danzon of Duke University analyzed malpractice claims closed by almost all insurers in the mid- to late 1970s. Her conclusions were:

- Limits on the dollar amount of awards, including caps and provisions for periodic rather than lump sum payments, appeared to cut average settlements by 25 percent, to raise the proportion of cases dropped from 43 to 48 percent, and to reduce slightly the share of cases going to verdict.

- Relaxation of the ban on introducing evidence of collateral sources of compensation available to the plaintiff appeared to reduce settlements, although the statistical significance of this finding was low.

- Limits on attorneys' contingent fees cut average settlements by nine percent, somewhat raised the number of cases dropped without payment, and slightly reduced the percentage of cases going to verdict.

As legislatures tackle the thorny issue of controlling liability insurance costs during the upcoming legislative sessions, they need to carefully weigh the expected benefits of actions which may reduce the ability of defendants to sue, cap awards, limit attorneys' fees, or involve expensive or cumbersome administrative actions.

NCSL Contact: Barbara Yondorf, Denver.

Editors' Note: This is the first in a two-part series on the liability insurance problem. The second article, which will appear in the January/February [illegible] edition of <u>The Fiscal Letter</u>, will take a closer look at the effectiveness of different strategies in controlling liability insurance costs.

Mr. FLORIO. Thank you very much for your very succinct and good testimony. We are going to ask all of our witnesses to try to keep their remarks to 10 minutes so we can have maximum time for the interchange that is really the essence of what this process is about.

Mr. ZUCCARO. I could hear the bell coming, Mr. Chairman.

Mr. FLORIO. Yes, I am impressed. I am awed that you are able to time your remarks right to the second.

My understanding is that when you said the States are going forward with modifications in their tort law and product liability questions that that translates into your organization's opposition to Federal activity in terms of uniform product liability reforms. That you are not supportive of any Federal law to change the State tort laws or the State product liability laws?

Mr. ZUCCARO. In the area of product liability, NCSL has taken the position that we oppose Federal intervention in the area of product liability. We think that the appropriate place for those issues to be dealt with is in the State forums, where it has traditionally been dealt with.

Mr. FLORIO. So it is largely a philosophic position?

Mr. ZUCCARO. That is right. The entire question of preemption of State activity in areas that have been traditionally the concern of States. I think NCSL has consistently taken the position that there should not be Federal preemption in those areas where States have traditionally exercised control and authority.

In the area of liability insurance, I think the States, as I indicated in my prepared remarks, have been moving forward and have been taking many initiatives. And I would suggest that it would be appropriate to give those actions an opportunity to proceed to determine the real effect that will be realized from it. And I think, if it is determined that those actions have not been effective, at that point it should be reexamined, whether the Federal role should be expanded to address those same issues.

Mr. FLORIO. We have testimony later in the day from the National Association of Insurance Commissioners. And one of the—and I made reference to this in my opening remarks—one of the statements in the submitted testimony, and I quote it, "The solutions that could positively impact on the problems have already been implemented," which seems to suggest—and we will get some clarification—that there is not that much left to do except to just go forward and implement whatever modifications have been implemented.

Can you give us your thoughts on the validity of that general statement?

Mr. ZUCCARO. I think that many of the ultimate responses have been started. Whether they have gone far enough, whether they are broad enough, and whether they, in fact, will be an effective response to solve the problem, I think it is premature to say. And I would not sit here and suggest to you that there is no reason to do anything further.

As I indicated, I think it is important for this committee to proceed, to be a forum to analyze the effectiveness of what is taking place in the States. And at some point, a decision will have to be made, in fact, whether the problem has been solved or not.

I do not think it has been solved at this point. I think we are on the road to solving it, and I think steps have been taken to do just that.

Mr. FLORIO. Are you convinced that the various State regulatory agencies that we have—presumably the ones that you are most familiar with as a representative of the National Association—really have the capability and the resources to perform the function that we expect of them in an effective way?

Mr. ZUCCARO. I would suggest that the adequacy of the level of State regulation probably varies considerably from State to State. Some, I think, are probably doing an excellent job. Some are doing a less than excellent job. I think the capacity is there.

And I think in those States that have not been sufficiently effective in regulating the industry, at some point we will recognize that, and I think steps can be taken to ensure that they have the ability to do so.

The States have effectively regulated public utilities. And I think that similar effective State regulation is possible in the insurance industry. Some States have been slow to recognize the need and the dimension of the problem with regard to State regulation. But I do not think the States lack the capacity to do so. Some of them may not have gotten on track quite as fast as others.

Mr. FLORIO. We are going to hear from the insurance commissioners in a while. I would just run down some of the lists, some of the items that have been already presented to us as problem areas and some of the proposals, and just ask for your thoughts on any of them, if they strike you as particularly significant.

The problem areas that have been suggested are reinsurance—the inadequacy of the State regulatory authorities to have any degree of meaningful control over the business. Solvency questions have been brought to us. Mergers, selective underwriting; policy forms development; proposals for Federal reinsurance; expansion of a Risk Retention Act that is currently on the books, and authority to allow financial services at the State level to go into aspects of insurance—other financial services industries to go into the insurance business. Working from the premise, one presumes that competition will be good for the ultimate consumer.

Do any of these jump out at you as something that is a more significant thing than any of the others?

Mr. ZUCCARO. All of these are areas that the States in one form or another have been looking at. Some States, obviously, more seriously than others. I cannot speak to the issue of reinsurance. It is not an area that I have any particular expertise. And I would ask at some point the NCSL staff, if they have got something they would like to submit on that issue that we would offer——

Mr. FLORIO. We would be pleased to receive that.

Mr. ZUCCARO. In the other areas, the question of solvency, Vermont has not had any problem in that area. We had one foreign corporation that was doing business in Vermont that had a solvency problem. Ultimately, all of the policyholders were protected with the existing State fund to protect those policyholders. So that there were no losses to any consumers or policyholders in Vermont, and that has not been a problem.

The question of financial services is one that is coming to the front burner. Vermont, along with a number of other States has been exploring the financial services industry, and consideration to the question of interstate banking, and the question of providing services by banks that expand well beyond traditional banking services. And insurance is clearly one of the areas that people are talking about expanding into.

I think that, speaking personally, that we have got to be cautious in the level and degree of expansion we permit to ensure that we do not have a situation that losses in one area would have the potential of affecting other areas of the business. And we do not want to cause a problem that presently may exist in the insurance industry to spread to the banking industry because we allow banks to get into the insurance business.

But I think that those are areas that are—people are looking at and people are talking about. No question about it.

Mr. FLORIO. I yield to the gentleman from New York.

Mr. LENT. Thank you. First of all, Representative Zuccaro, I want to thank you for your testimony. It has been very helpful. The gist of what you are saying here is that we should have these hearings, we should monitor the insurance industry, and we should keep an eye on what the State commissioners and the legislatures are doing to correct some of the unevenness that we see in the industry. We should not, however, jump into this issue with some sort of legislation unless events eventually prove that, for one reason or another, the States were unable to get us over the present hurdles. Is that a correct representation?

Mr. ZUCCARO. Yes, I think that is absolutely correct. I think, many of the initiatives that I described have only been adopted within the last legislative session or the preceding legislative session. And from the effective date, there is a period of time of implementation, and I think we are just now beginning to see some effects from some of the actions that have been taken.

Some of them have been successful. Quite frankly, others have not been successful. And what may work in one State may not work in another.

I think that is one of the principal arguments for letting the States try to do it. Because if we try to do it on a national level, you may be focusing on problems that are problems in a majority of States, but also imposing those same solutions on States where it is not going to have any effect at all, or may even have an adverse effect.

Mr. LENT. So you are not recommending that we legislate in some particular way or do something with McCarran-Ferguson?

Mr. ZUCCARO. I am not.

Mr. LENT. We had some witnesses in one of our previous hearings which placed some of the blame for the current insurance crisis on the premium price cutting that took place back in the late 1970's and early 1980's when interest rates were high. There was great competition among the insurance companies for premium dollars so that those dollars could be invested.

One of the points that was made, as I recall, was that somehow the State insurance regulators or State law should have prohibited the insurance companies from reducing their premiums during

that period, when the companies were receiving record interest returns on their investments. Do you think that would have been a proper function or a step that might have been taken?

Mr. ZUCCARO. I presume it is a step that might have been taken. I think the sophistication of insurance regulation has increased dramatically since some of the problems that have brought about this insurance crisis have come about. And I think that clearly in the structuring of rates, soundness becomes an issue.

Mr. LENT. Think about this politically. If the insurance companies were making all kinds of money on the investment side and they did not lower their premium rates, which is what they actually did, what would the effect have been across the country? What would the insurance commissioners have done looking at these profits and companies not lowering their rates?

Mr. ZUCCARO. No one ever complains with rates going down. There is no question about it. And I think——

Mr. LENT. Had rates not gone down there might very well have been complaints all over America.

Mr. ZUCCARO. Absolutely.

Mr. LENT. Including right here in this committee.

Mr. ZUCCARO. Absolutely. And I am not going to sit here and try to suggest to the committee that I have any expertise in the area of the insurance rating process.

I think that what the States have got to ensure is, that there is effective legislation in place to permit rates to be set that will be fair and will afford protection to the public, will ensure solvency for the companies, and a reasonable rate of return.

Mr. LENT. You have said at page 12 of your testimony, that corrective action at the Federal level, however, ought to be taken in areas of environmental liability insurance and truckers' coverage. This seems to be carving out a couple of exceptions to the general rule. And what type of Federal action might you be thinking about in those areas?

Mr. ZUCCARO. I think those are areas where Federal legislation has already—an area the Federal Government has already taken a role. And we are not suggesting expanding that role, but we think that in the area where the Federal Government is already involved, if there are particular problems that it is appropriate to be addressed at the Federal level.

Mr. LENT. You do not have any suggestions?

Mr. ZUCCARO. I do not have any specifics.

Mr. LENT. I have no further questions.

Mr. FLORIO. Mr. Sikorski.

Mr. SIKORSKI. Thank you.

Thank you, Representative Zuccaro. I appreciate your testimony, and I've read it over.

I served for a few years on the Human Resources Committee of the NCSL and now sit on our Select Committee on Children, Youth and Families. We had a hearing recently on the dramatic increases in insurance costs for child care providers across the country.

Have you heard from the Human Resources Committee or others on the problem of availability, and affordability, of liability insurance for child care providers? And have you seen anything happening on the State level in response to it?

Mr. ZUCCARO. Yes. I think the question of availability and affordability of liability coverage in the child care area, and also in the area of nonprofit and volunteer organizations is really very, very similar. And they have a real difficult time.

I think that some of the steps that they have taken in that area have been—in Vermont, we recently empowered the commissioner of insurance to set up a joint underwriting association in those areas where he makes the determination that there is a lack of availability or costs make the coverage unaffordable, to mandate the establishment of a joint underwriting association to provide those lines of coverage.

Now, that was set up as a 1-year experiment. And if it appears to be working, I expect it would be extended. If there are problems, those problems will have to be dealt with.

The area of MAP's is also an area that has, I think, been put into place to deal with the question of availability of coverage in all those areas that coverage is just not available, just not there. And that is a real problem. And whether those initiatives will be sufficient, only time will tell.

Mr. SIKORSKI. Thank you.

Thank you, Mr. Chairman.

Mr. FLORIO. Let me just develop two last points very briefly. One is the point that Mr. Lent raised here and has raised previously about the difficulty of attempting to induce insurance companies—I suppose to put it in a different way, the difficulty in not allowing insurance companies to reduce premiums.

In State regulation—even in Federal regulation at the ICC—the concept of predatory pricing is clear. Most people understand pricing below costs is there and is not a preferred approach. It may very well be used in some instances to capture market, inappropriately to concentrate the market.

In this instance, the concept of cash-flow underwriting is one that I understand is almost acknowledged by some in the industry as taking place under certain circumstances. Those circumstances apparently existed at the end of the seventies, high interest rates, good investment income.

Is it really that difficult for the insurance—and I am not saying politically difficult, because I think the politics can be justified, if in fact you are talking about preserving the integrity of the insurance company and industry so as to survive the next downturn in the cycle. The concept is not one that I think is beyond the capability of insurance regulators to incorporate into their review process, assuming they have a review process.

Now I am not unmindful of the fact that in some instances in commercial insurance, the insurance industry regulators have no process because it has been totally deregulated, in reviewing those rates.

But if there were to be some responsibilities, do you, from your experience, regard it as difficult, if not impossible, for either underwriters themselves or underwriters under the guidance of insurance regulators to evaluate what the prospects are for the ultimate payout, and therefore, to keep a band of premium fluctuation in mind, which apparently was not the case? Do you regard that as unreasonable?

Mr. ZUCCARO. I think that that is clearly one option.

Mr. FLORIO. Do you regard it as a function, assuming you do not have a situation where there is total deregulation in commercial lines. Do you regard it as a function of the regulators to play some role in ensuring that the twin problems of gouging for rates that are clearly inappropriate, or providing for rates that are inappropriate to meet the ultimate responsibilities of the insurance companies?

In those situations, do you regard those as legitimate and maybe even required functions of an insurance regulatory system?

Mr. ZUCCARO. Well, I think ultimately the State legislatures that are going to consider the degree of regulation that they are going to have, and the degree of authority the various insurance departments and insurance commissions are going to have in ratesetting, is the place where the question should be determined.

Mr. FLORIO. There are some proposals, and I think we are going to hear about them today, at the State level, that there be some correlation between premiums and payouts. And that sort of a system should be implemented where it is not. And, of course, that would be a substantial policy change at the State level in some States.

I assume that some States, at least pay lipservice to having that now. Whether they do or not, we will find out momentarily.

Let me ask one last item, and it is really not related too terribly much to what we are talking about. You brought it up in your remarks. I have been interested, because in my State we have the same problem that you apparently do in Vermont.

A court decision that came down holding a host responsible for overconsumption of alcohol at a private party, and then the individual going out, and getting in an accident, and hurting someone. That is very controversial in my State, as apparently it is in your State. And there is a proposal to change—effectively, to overrule—the court decision with some liability.

I am not offended by the decision, because the decision does not translate into blanket responsibility. The decision was on a factual basis. And in certain circumstances I can conceive of—and I think most people probably can conceive of—factual situations where the host should be responsible.

The difficulty is that translates, in some instances, on the part of industry—the insurance industry—into worst-case scenarios becoming the norm. So that one says, well, this increases the risk dramatically that there be payouts. There will be this blanket liability. And therefore, we have to calculate rates to take into account this new enhanced liability, when review of the particular case and review, one would think, of just a commonsense interpretation of what the court was trying to do would not result in expansion of tremendous amounts of liability.

What you are talking about is the situation where—to make a ludicrous example—someone pours three bottles of whiskey into somebody, puts them in the car, turns on the key, and turns them loose into a crowded municipality. That host should have some degree of responsibility.

But that is not to say that everybody that passes through the house that has a drink then becomes liable for everything that happens when the person leaves the house.

Have you any thoughts or suggestions—I am not sure how intimately involved you are in the legislative deliberations on this particular question—as to how one refines the insurance ramifications of particular liability court judgments that occur on restricted factual grounds for which there is no great liability in a more expanded sense?

Mr. ZUCCARO. I think one of the problems is that this creates a new area of potential liability that was not considered when policies were originally written, when rates were originally structured. That, I think, is one problem.

And I think you are quite correct. That bad facts usually make bad law. And you get cases where you have outrageous conduct which produces a decision, which is then cited as precedent and becomes a test. And many cases that follow get decided on facts where the conduct is not nearly so outrageous. And if that was the particular case that had gone on in the first instance you might not have had the change in the law at all.

And I have some concern that that decision may produce a result that every time there is a automobile accident where liquor was involved, if that person at any time had consumed any of that liquor at a private home, or at a private party, that the only prudent practice is going to be to name that individual as a codefendant, and we will have significant increased costs ultimately, just for the cost of defense, whether there is any ultimate liability or not. And that could have, in my judgment, serious implications down the road.

Mr. FLORIO. Thank you, Mr. Zuccaro. A very thoughtful response. Let me thank you very much. If there are no further questions, I would like to express our appreciation.

Mr. ZUCCARO. Thank you, Mr. Chairman, I appreciate the opportunity.

Mr. FLORIO. Thank you.

We are now pleased to have a distinguished panel of insurance regulators from the various States. I would like them to come forward. The Honorable Edward Muhl, the Commissioner of Insurance of the State of Maryland; the Honorable William Gunter, Commissioner of Insurance, State of Florida; the Honorable Lyndon Olson, Jr., State Board of Insurance, chairman of the board, Texas; and the Honorable John Washburn, Director of Insurance of the Illinois Insurance Department.

Gentlemen, we welcome you all to our committee. We are very pleased to have you back, particularly our former colleague from Florida. We would ask that you try to keep your remarks to approximately 10 minutes so that we can have some interaction.

And I would ask Commissioner Muhl, please to start.

STATEMENTS OF EDWARD J. MUHL, VICE PRESIDENT, NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS; JOHN E. WASHBURN, DIRECTOR OF INSURANCE, STATE OF ILLINOIS; LYNDON L. OLSON, JR., CHAIRMAN, TEXAS STATE BOARD OF INSURANCE; AND WILLIAM D. GUNTER, FLORIDA INSURANCE COMMISSIONER

Mr. MUHL. Mr. Chairman, I am delighted to be here, along with my colleagues who you have already introduced. Let me just explain just a couple things about my colleagues before I get into making an opening and brief remark.

Lyndon Olson is one of the three Texas board members, also chair of the Texas Board of Insurance, past president of the NAIC, and has served as chairman of the National Association of Insurance Commissioners Reinsurance Task Force for the past 4 years.

Commissioner Gunter is also the past president of the NAIC, and is very integrally involved in the entire process.

And I am sure all of us here will be in a position to answer any of the questions that you have.

First, let me suggest to you that on behalf of our many colleagues, I am very appreciative of the opportunity to appear, along with my colleagues here, to offer testimony which, hopefully, will be of some benefit and interest to you and your committee.

I would like to just have a few brief opening remarks. I am not going to reiterate the bulk of the testimony which we have given to you in writing.

Mr. FLORIO. Incidentally, all of the remarks of all the witnesses today, their formal statements will be put into the record in their entirety.

Mr. MUHL. Very good. We appreciate that.

Let me just suggest to you that State insurance regulators, for the most part, Mr. Chairman, are not newcomers to the problems and the concerns that you have been addressing. We have been pretty much on the front line handling these concerns and problems every day, each and every moment of every day.

And we have been talking to the family day-care operators, the long haul truckers, and municipalities, counties, and others, including the insurance industry, because they also are impacted by this situation, concerns, and problems that face them all.

We have a good understanding of the problems, and in my opinion, and equally important, a very good understanding of the solutions needed. Many of the solutions that could—and I think you alluded to this earlier, from the written testimony—many of the solutions that could positively impact on the problem have been implemented.

That is not to suggest though, Mr. Chairman, that all of the solutions to the problems have been brought forth. But a lot of what could be done in the timeframe that we have been operating in, has been done.

The insurance industry and the individual companies that comprise this industry are not unregulated. As a matter of fact, they are highly regulated, and in my personal opinion, well regulated by the many States. There are critics of State regulation, as there are critics of Federal regulation. But I strongly suggest to you that the

regulation by the individual States is alive, and well, and very capable of responding to the needs of the citizens that we serve and that you serve as well.

The National Association of Insurance Commissioners is an organization comprised of the regulators of all the States, including the four U.S. territories. It is an organization that brings the State regulators together to share in the problems, and particularly the solutions, that transcend the jurisdictional boundaries.

Our organization assists in supplying the uniformity needed in those most critical areas dealing with solvency and financial regulation, and at the same time provides for the individuality of the several States where some of the problems and some of the solutions to those problems are unique.

The NAIC does provide a national forum, but assures individual State identities, because all States are not experiencing the same problems, nor the same degree of severity of those problems. Each State is unique in the problems they face, although having some similarities, may be different as the solutions will be different.

Mr. Chairman, as a result of you having already received the written testimony—and I do appreciate your thoughts about including that in the permanent record—I would like to turn it over to Director Washburn from the State of Illinois, who would like to offer some comments as well.

[Testimony resumes on p. 547.]

[The prepared statement of Mr. Muhl follows:]

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National
Association
of Insurance
Commissioners

February 20, 1986

The Honorable James J. Florio
Chairman
Subcommittee on Commerce,
Transportation and Tourism
U.S. House of Representatives
Washington, D C. 20515

Dear Mr. Chairman:

My name is Edward J. Muhl, Insurance Commissioner of the State of Maryland and Vice President of the National Association of Insurance Commissioners. I am here representing the NAIC which is an association of all the regulatory officials of the fifty states, District of Columbia and the four U.S. territories of Guam, American Samoa, Virgin Islands, and Puerto Rico.

On behalf of my many colleagues and the NAIC, we thank you for the opportunity to appear before your committee and to offer testimony which we hope you will find of benefit and interest.

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Mr. Chairman, allow me to preface my remarks by first noting that the State Insurance Regulators are not newcomers to the problems that you are addressing. We have been on the front line dealing with these issues every moment of every day listening to the complaints of the family day care operators, the long-haul truckers, obstetricians, municipalities and counties and the many others, including the insurance industry, who are affected and impacted by this situation.

We have a good understanding of the problems, and equally important, a good understanding of the solutions needed. Many solutions have already been offered which have been molded to the best interest of the citizens in our individual jurisdictions. The solutions that could positively impact on the problems have already been implemented and a lot of what can be done, has been done, by the several states.

The insurance industry and the individual companies that comprise this industry are not unregulated. As a matter of fact, they are highly regulated, and, in my opinion, well regulated by the many states. There are critics, Mr. Chairman, of the state regulation as there are critics of federal regulation. But I strongly suggest to you and to your committee that state regulation of insurance is alive and well and quite capable of responding to the needs of the citizens we serve on matters within our control.

The National Association of Insurance Commissioners serves to bring together the state regulators, to share in the problems and particularly the solutions that transcend jurisdictional boundaries. Our organization assists in supplying the uniformity needed in those most critical areas dealing with solvency and financial regulation and, at the same time, provides for the individuality of the several states where some problems and the solutions to those problems are unique. The NAIC provides a national forum but assures individual state identities because not all states are experiencing the same problems nor the same degree of severity. Each state is unique and the problems they face, although having some similarities may be different as the solutions will be different.

In order to fully understand the availability concerns existing today, it is important to understand the several component parts of the problem that has brought us to this point.

There are approximately 5,500 licensed United States insurance companies of which approximately 2,100 are life and health insurance carriers. The remainder, 3,400, are property/casualty insurers. This 3,400 is further identified as having approximately 53% who underwrite personal lines of insurance only such as automobile and homeowners, and the remainder of the 1,600 are licensed to write commercial insurance which includes workers

compensation, commercial automobile, commercial multi-peril and commercial general liability and specialty lines. If you exclude workers compensation companies, you would have approximately 1,100 companies writing various of the commercial lines in question.

Each of these companies represent individual independent businesses of different sizes and different capacities or abilities to write insurance, who are seeking to sell their products, pay expenses and earn a profit not unlike any other businesses that function in our free enterprise system. Each insurer who ventures into this business of risk taking and risk sharing does so with the logic and thought that if they can predict their loss exposure, they can charge an appropriate premium and thus make a profit. Unfortunately, it's not a very simple or easy process because of the many forces that come to bear on the system. Competition, government and regulatory controls and intervention, predictability and measurability of risk exposures, reinsurance, world economies and the management ability of individual insurers to name a few, serve to have a direct as well as indirect bearing on the functioning of this system as a whole.

The business of insurance historically has been cyclical in nature. The companies evaluate their risks, attempt to predict with as much certainty as possible their future losses, and adjust their premium, up or down, to cover those predictions as to losses while attempting to remain competitive. The pendulum, in years

past, would swing in near three year cycles due, in part, to a degree of stability that existed in a world economy, the ability to spread the risks over a large base of insureds and an availability of secondary or reinsurance to fill the capacity voids of the primary insurers.

The task though of predicting future losses, measuring and evaluating risks and spreading that risk has become difficult. Narrowly defined and limited contracts have been broadened by judicial interpretation. Insurers on a consistent basis are being required to pay for risk exposures that were never intended or contemplated by the insurance contract and, equally important, where a premium was not previously collected for such an exposure.

The bulk of this has translated into solvency concerns for major segments of the insurance industry, and thus directly impacts on the ability or the capacity of the industry to write either new or existing lines of insurance. The primary carriers in the United States market never had the capacity to write all the insurance demanded by the various markets. Therefore, there was a strong reliance on the reinsurance facilities to fill this capacity void. Unfortunately, the losses sustained by the primary carriers have also been sustained by the reinsurance facilities which has caused them to reevaluate their position in the market. Reinsurance has been disappearing for certain of these lines or the costs of reinsurance to the primary carriers have increased

dramatically for yet other lines. thus exacerbating the problems noted.

The insurance industry is responsible for self-inflicting some of the wounds they sustained due in part to their participation in the cashflow underwriting process. We had an uncontrolled economy with double digit inflation and an unprecedented prime interest rate of 21% leaving open the door for the many insurers to indulge in certain practices which aggravated and worsened the cycle. Insurers were able to convert low premium dollar income for high short-term investment yields, thus creating a large volume of ill priced and, in some instances, long-term business on their books. Competitive forces were quite fierce.

The interest rates fell dramatically over a relatively short period of time leaving the insurance industry in quite a dilemma. There was a fear that to raise prices in some semblance of order to compensate for the risk exposures would mean a loss of marketshare. The industry, for the most part, was unwilling to make such a timely transition and was severely caught in a time lag of recovery. To make matters worse, many companies, now experiencing solvency concerns and with fear for survival, were withdrawing from many of the markets totally. There has been an overreaction in many instances where some of the companies have withdrawn from the unprofitable as well as the profitable markets causing dislocation of many policyholders.

It is important to remember that all insurance companies do not write the same lines of insurance nor do they have the same capacity or expertise. Much of the commercial business is written by specialty companies or companies that specialize in certain markets. Medical malpractice for an example, is written in varing degrees and amounts by approximately 30 insurance companies. Day care, particularly commercial day care centers were written by just a few carriers, Mission Insurance Co. being the primary one. Mission ultimately sustained capital and surplus deficiencies and was unable to retain certain of its reinsurance contracts.

Mission was recently taken over in rehabilitation, thus dislocating quite a few day care centers nationally. Many of the other commercial lines carriers were not geared to write such coverages and due to the perceived volatile potential for loss, few if any initially moved to fill this capacity void.

Many factors, some controlled while others uncontrolled came to bear on the industry thus creating the most severe cycle in the history of insurance. State governments and regulators responded by offering immediate relief where possible and identifying other short term as well as longer term solutions to the many problems. The individual states as well as the NAIC responded promptly by creating market assistance programs, searching for alternative insurance sources, establishing a national clearinghouse of availability information and exploring legislative involuntary insurance mechanisms such as Joint Underwriting Associations. Using my state as an example, Governor Hughes of Maryland,aware of the then growing availability problem, supported legislation in the 1985 General Assembly that allowed Maryland's Medical Malpractice Insurance Company to expand it's writings to other health care professionals. This has served to create an available malpractice market for nurse mid-wives, dentists, and other health providers.

Concerned also with the severity of the availability and affordability problems, Governor Hughes formed two separate task forces, one on medical malpractice and one on general liability for the other commerical markets. The major thrust was to identify specific causes of these problems and to determine the most appropriate administrative and legislative solutions. The Governor has submitted a comprehensive package of bills to the legislature that will have a meaningfull impact on these problems. Many of the state jurisdictions are proceeding in a similar manner.

The individual state regulators in coordination with the NAIC responded to these problems. The following represents a summary of the various actions taken:

1. There has been a universal response by all state insurance departments by law, order, regulation or notice prohibiting companies from cancelling at mid-term of policy contract or attempting to raise premiums mid-term of contract.

2. Proper notice of non-renewals is being required to allow the insured sufficient time to find alternative markets.

3. The majority of states have created voluntary market assistance programs and open telephone hotlines. The market assistance programs are efforts to create markets where none presently exist, matching buyer and seller of insurance. These efforts have worked quite well, particularly in the area of day care liability.

   The NAIC has responded by creating a National Clearinghouse concept gathering information as to specific company capacity in specific geographic areas and disseminating that information to the states for use in their market assistance programs.

4. Market conduct examinations are being initiated by the states of any insurer whose market practices and activities are questioned. Several examinations have commenced and have been completed. Insurance companies found in violation of any of the insurance laws are taken to task.

5. Many states are addressing availability problems by sponsoring legislation which creates involuntary insurance mechanisms such as Joint Underwriting Associations (JUAs). As a prerequisite to licensure, all companies licensed in a given state will have to accept certain of these risks as insureds with that company.

6. The majority of the states, either through their Governor's Office, Insurance Division or the State Legislatures have formed special task forces to review the unique problems of these states and to suggest legislative remedies. These legislative initiatives take various forms depending upon the need of the local jurisdiction. Some of the noted initiatives deal with meaningful reform of the legal liability system: (a) caps on awards; (b) reinstitution of governmental immunity; (c) re-evaluation of competitive rating versus prior approval rating mechanisms; (d) joint underwriting associations or legislatively created market alternatives such as medical mutual liability insurance companies, lawyer's malpractice insurance mechanisms and other residual market mechanisms; (e) malpractice arbitration mechanisms for health providers; (f) strengthening peer review and professional licensing procedures (g) elimination of legal barriers allowing for pooling of risks and self-insured programs for governmental entities; (h) limiting counsel fees in certain circumstances based on percentage of the award; (i) reducing the statute of limitations in cases of a minor.

7. The NAIC has formed a legal liability task force to review the legal liability system and the effect it has on the consumer and the availability of insurance generally.

8. Premium rates are being monitored and reviewed to determine whether the rates charged are excessive for the product being sold and the risk exposure that is attached. Premium rates are also being monitored to determine if they are inadequate as well as unfairly discriminatory.

The states share in the concerns of availability and affordability and the impact this has on our citizens, insurance consumers, and industry alike. Many efforts are being made to resolve these problems, and we are pleased to suggest that a great deal of progress has been made. Insurers are rebounding and voluntary efforts are being seen to address these concerns. Continental Insurance Company, USF&G, and Liberty Mutual, to name three, have announced insurance programs created to insure day care facilities. Other carriers have initiated programs to insure yet other commercial entities which is a positive sign of recovery.

There are risks, though, that cannot and probably should not be insured because of the inability to measure the cost of such risks. I refer to pollution liability in its various forms as one example. Unless changes are made, and the liability system provides more stability, these risks will not be insurable at any cost.

We are finding many businesses and individuals going self insured for many risks which result only in a temporary or interim solution. The difficulty remains in that by self insuring, they are merely transferring the method of payment and not addressing the root cause of the rising cost.

The last issue that I would like to address deals with solvency. One of the most important roles of a regulator, in addition to consumer protection, is insurance company solvency protection and insolvency detection. When a company enters into an insurance contract and collects a premium, they make a promise and a commitment to the policyholder. These

policyholders come to rely on that promise and it is important to assure that these companies remain viable and able to fulfill their promise and commitment one year, five, twenty or thirty years in the future. In the unfortunate event of an insolvency, the policyholders' interest must also be protected.

The individual state regulators take their statutory charge quite seriously and attempt to provide those protections necessary. For your information, Mr. Chairman, the many states provide, in coordination with one another and with the assistance of the National Association of Insurance Commissioners, one of the most advanced solvency monitoring mechanisms available. We are able to devote staff resources in excess of 6,000 personnel to the various regulatory functions. There are over 1,800 highly qualified and experienced financial and market conduct examiners, and the states contribute over 200 million dollars each year toward the cost of regulation.

On behalf of the NAIC and my many colleagues, I would like to again thank you for the opportunity to appear before your committee to offer testimony. I will be pleased to answer any questions you or your committee members may have.

Respectfully submitted,

Edward J. Muhl
Vice President NAIC

STATEMENT OF JOHN E. WASHBURN

Mr. WASHBURN. Thar'. you, Mr. Chairman, Mr. Lent, Mr. Sikorski. I appreciate the opportunity to come here today.

I do not want to be redundant about the problems, but I thought it might be helpful to just talk about what I see happening in Illinois, and how we are trying to respond to the problems that a· out there. I will restrict my remarks to liability insurance, because I think it is the area that we have had the greatest price problems and the greatest availability problems.

The fact that the casualty insurance underwriters were underpricing their product is shown both in their actions that they have taken in the last couple of years, and in the reports they send to State insurance commissioners. In Illinois, in 1985, we had a 33-percent increase in the number of companies that were on our troubled company watch list. You look at that compared to 1983, it is a 100-percent increase in the number of companies that we have had to monitor.

Indeed, several large conglomerates have had to send money to their insurance subsidiaries. And I talk about American Express to Fireman's Fund, Xerox to Crum & Forster. And they have had to send appreciable amounts of money just to ensure the viability of those companies.

There have also been some major insurance concerns that have had to add money to their reserves, because they felt they were underreserved. You all have probably heard about CIGNA, USF&G, and Continental in just the recent months have had to add money to their reserves because they felt they were underreserved for some of the policies they had written prior to 1985.

Now on some occasions there was no parent company or no surplus, or the parent was unwilling or unable to send money down, and there have been insurance companies that have had to cease the business of insurance, simply because they were no longer viable.

Now the belated response of the industry to their losses has caused problems in Illinois, much the same way it has caused problems in other States. We have large price increases, midterm cancellations, and a rash of complaints about not being able to find coverage at any price. In Illinois, we have attacked these in a series of ways.

Midterm cancellations when they were first put together had a very good rationale behind them. They allowed the insurer and the insured to sort of get together and be innovative on the types of coverage they would afford. The insured could talk the insurer into going with a particular type of price or a new type of coverage and if it did not work out, in midterm they could cancel and start anew. They could go back to the old system.

For years that allow some innovation in the insurance marketplace that might not have taken place otherwise. The problem, of course, is the fact that this ability to innovate also gave the insurers some flexibility in term of midterm cancellations, when there was no innovation to start with. And some insurers abused this privilege.

So, in Illinois, we passed a law that prohibits midterm cancellations, except for specific reasons.

Mr. FLORIO. The previous approach was mutually agreed to?

Mr. WASHBURN. The ability to midterm cancellation allowed a mutual agreement between the insurer and the insured Midterm cancellat ons were an aberration, to be quite frank. They were not a norm in the industry prior to this. And they allowed a little flexibility between, basically the broker, the insured, and the insurer to come up with some innovating if they wanted to do that. With the whole thought that if it does not work, we can get out of it and start anew.

Now I do not know how much it was used, but it allowed that. It was not very much abused until really very recently. And then it was abused a great deal, where there was no innovation to start with. I mean, there was an actual abuse by the companies. And so we have had to take out that flexibility in the structure.

Now we are attacking the availability problems through a market-assistance program. And some of the availability problems we find are because the agents or brokers really are not knowledgeable about which insurer is willing to write the particular type of risk that he is trying to place. There are really no agents or brokers in Illinois that are affiliated with all 400 companies that are writing casualty business in Illinois.

And so, the market assistance program basically puts a structure, a grouping of both producers and underwriters who are collectively knowledgeable about what is going on in the marketplace. And in that way, if an agent or broker cannot find a company that is willing to write, he submits an application, and the market assistance program can find a writer for that type of risk. At least that is the hope.

There is also the incentive for the participating companies to help provide coverage. They know that if they do not provide coverage, they are going to be faced with some sort of a structured—an involuntary market mechanism for the particular types of risk that cannot be written.

Indeed, one of the advantages of a market assistance program is they will help determine what truly is unwritable. What the industry does not wish to write. What they do not think they can write.

These uninsurable risks may vary from State to State, depending on both the legal framework or the uniqueness of the State.

In Illinois, we have a program for mine subsidence. Basically, a lot of Illinois had underground mining. Homes were built over this. The city of Springfield itself is built over a series of underground mines. These mines may subside. There may be water that eats away the structure, and the mine may cave in. That is not covered under a normal insurance program.

In Illinois, we have a special program for mine subsidence. It is really not needed in most other States.

Now the pricing is, of course, the most difficult problem for us in Illinois. In Illinois, we have long held the belief that with many sellers and no dominant writer open competition was the better determinant of the price. This worked very well for the consumer over the last several years. But large-scale discounting off of rates

advised by the industry organizations, the consumer got a very good deal for his insurance.

Now this happened again because the companies were competing. They were out there trying to make money. And they thought they had the ability to do that.

Now what happened was the companies lost money basically on policies they have written. And they are just seeing the losses on policies they wrote years ago.

The question is, why did they lose money? Well, they had cash-flow underwriting. They thought they were going to make money on interest rates. The collective judgment in those days was interest rates were going to stay high for the next several years, that there was no way they could really come down. So they lowered the price. They went out to get the business.

The stiff competition forced companies that did not believe in cash flow underwriting to reduce their rates just to keep their market share. Just to keep their good risks they had to reduce rates

In 1981 Aetna came out and said the price is too low. We are not going to play this game. We are going to raise our prices because that is what we think we ought to do. And in a very short period of time, they lost 20 percent of their business. And their good business fled. They eventually had to capitulate and lower their rates because they were just losing their good business.

Commercial liability is also very difficult to price. There is a long time between when you price the product and when the claims come due. And that causes sort of a problem on trying to determine what is a correct rate. What is the interest rate going to be for the next several year. maybe 10 or 15 years? What is basically going to be the collective judgment of how much ought to be paid out?

So it makes it a very difficult product to price. Liability is more difficult than property, because you do not see the claims as early as property.

Availability of cheap reinsurance. People wanted to get into this whole—people wanted to get into financial services, and it is very easy to do through reinsurance.

There was also, because of some rulings out of the Treasury Department an impetus for captive reinsurers. For major companies that were formed in the mid-1970's to get into the insurance business in a lot heavier way, to prove that the rates they were charging their parent were adequate.

So you had an availability of cheap reinsurance, and that allowed companies to take a chance. That allowed them to write business at a cheaper rate.

The last is the court decisions on awards which are retrospectively changing the size and the nature of the risk, with no ability to retroactively charge a premium. That caused a great of problems for the industry.

Now what we are trying to do in Illinois is see how extreme have been the price increases and what risks are affected. In some cases we are finding discounts of 75 or 80 percent off of the suggested rate by the industry organizations. There is such a large discount, you can understand that 100 percent—even a couple of hundred

percent increases—does not get them up to the level that was ostensibly the correct rate.

Now that does not help the guy whose rates have gone up 100 percent, and I am not trying to excuse the industry practice in trying to raise the rates in 1 year to make up for their shortfall in prices that have been falling down for several years. But at least, it is a more understandable thought when you see the rates increase as to whether they are at the correct level now.

In some ways the industry has tried to address the pricing problem created by the long-term nature by changing the policy, a new form. The so-called Insurance Services Office, ISO claims-made form. The policy will allow a company to close its books on business quicker, and hopefully adjust the rates in a speedier, and hopefully more gradual basis.

Now there were, in many eyes, a lot of problems with the original form that came out from the insurance industry. And the commissioners worked together, both with the buyers and the brokers, and forced the Insurance Services Office to change the form in a great manner just to get the necessary approvals.

Now this year in Illinois we are trying to address the problems we have already seen. Some of the problems deal with how the industry acts with its policyholders. We are going to have a bill to extend the period of time they have got to give notice of nonrenewal.

We are going to have a bill that mandates that they get the claims information in a speedier manner, so a policyholder who finds out he needs to go out and shop for the market has the information he needs to shop the market in a timely manner.

We are also going to be trying to address rates. But we are not exactly sure how to do it. It is a very complex problem in terms of allowing the policyholder at least some advance notice on when his rate is going to change upward in a great extreme.

At the same time, we are going to try and address the other side of the problem, which is tort reform. It is one area that legislatively can add more stability in terms of trying to determine rates.

In summary, we are aware of the problems that are out there. We have instituted or are in the process of instituting action to address the problems. Now many of the actions are portable to other States, and they will move. Other actions will deal with particular problems in a particular State.

In Illinois, if we see someone else who comes up with a good idea, we will steal it. We will use it in Illinois. And in that way, I think the system is going to work for us.

Thank you.

[The prepared statement of Mr. Washburn follows:]

STATEMENT OF JOHN E. WASHBURN

DIRECTOR OF INSURANCE OF THE STATE OF ILLINOIS

Chairman Florio and members.

Thank you for inviting me to testify today on what I see in Illinois occurring in the current insurance marketplace. I will direct my remarks to liability insurance as this is the area of greatest price increase and availability problems.

The fact that the casualty insurance underwriters were underpricing their product is shown in their actions and reflected in the reports they must send to insurance regulators. Indeed, several large conglomerates have had to send substantial, additional funds to their insurance subsidiaries to restore viability. On some occasions, there was no parent or the parent was unable or unwilling to send additional funds and the companies have had to close their doors and cease the business of insurance.

The belated response of the insurance industry to the situations has caused problems in Illinois in much the same way it has caused problems in other states. We have had large price increases, mid-term cancellations and a rash of complaints of not being able to find coverage at any price.

We in Illinois have attacked these in a series of ways. Mid-term cancellations allowed an insurer to take chances on types and prices of insurance it would provide an insured. If they found the situation to be different than imagined, the insurer could then cancel the policy mid-term This worked for many years until last year when some insurers abused this flexibility So, in Illinois we have passed a law prohibiting mid-term cancellations except for specified reasons

We are attacking the availability problem through a market assistance program. Some of the availability problems are due to the fact that the agent or broker may not be affiliated with or knowledgeable about a company that insures that particular type risk. There are no agents/brokers affiliated with all 350 companies writing commercial liability insurance in Illinois This market assistance program will assist the agent/broker to find a writer for a risk he cannot find on his own. There is also an incentive for the participating companies to help provide coverage for they know that they may be faced with an involuntary market mechanism if there are particular types of risks that cannot be written. Indeed, one of the advantages of this mechanism should be a clear recognition of what types are truly uninsurable. These uninsurable risks may vary from state to state depending on the legal framework under which they operate or the uniqueness of the state. For example, in Illinois we have in place a special program for mine subsidence a product not needed in most states.

The pricing is a more difficult problem in Illinois. In Illinois we have long held the belief that with many sellers and no dominant writer, open competition was the best determinant of the price. This worked very well in the last several years with large scale discounting off the rates advised by industry rating organizations. However, last year rates increased dramatically, in some cases astronomically. This happened again because companies were losing a great deal of money. Why companies were losing money is due to a variety of factors including:

- Cash flow underwriting whereby the company assumes it will make up underwriting losses with investment income.
- Stiff competition forced companies to reduce rates to maintain market share.
- Commercial liability insurance is difficult to price given the long time between the sale of insurance and payment of claims.

- o Availability of cheap reinsurance in early 1980's that disappeared in 1985.

- o Court decisions and awards which were retrospectively changing the nature or size of the risk with no ability to retroactively change the rate charged.

What we are trying to do in Illinois is to see how extreme has been the price increase and what risks are affected. In some cases, we are finding discounts of 75% to 80% off the suggested rate. With such a large discount a several hundred percent increase can better be understood.

One of the ways the industry is trying to address the pricing problem created by the long-term nature of the coverage is by going to a new form. This is known in the insurance business as the ISO claims-made commercial general liability policy.

This policy will allow a company to close its books on the business quicker and thus adjust the price on a speedier and hopefully more gradual basis. There were, in the estimation of the Commissioners, a great many problems with the original policy. Illinois took the lead in forming a group of Commissioners to address these problems with the ISO. The ISO has significantly changed the policy from its original submission in order to gain the necessary approvals.

In summary, we are aware of the problems. We have instituted, or are in the process of instituting action to address the problems. Many of these actions are portable to other states and in that way we are helping each other Other actions will deal with problems peculiar to a particular state, either in terms of unique characteristics or legal framework. Each state then has the ability to use the best of other states or develop new ways to address the problem This system shows the wisdom of our federal structure and allows us to truly be laboratories of democracy.

Mr. FLORIO. Thank you very much.

Mr. MUHL. Mr. Chairman, if we may, the commissioner from Texas, Lyndon Olson, would like to present some opening remarks.

Mr. FLORIO. Sure.

STATEMENT OF LYNDON L. OLSON, JR.

Mr. OLSON. Mr. Chairman, I think you have before you my remarks. And if you do not mind, I would like to be a little less formal. I probably will not take but about 5 minutes.

But were I sitting where you sit, frankly, there is nothing sacrosanct about McCarran-Ferguson. I think there is relative to State regulation. But if it does not work, if regulation is not tough and it is not effective, and it ceases to work, then I think that not only should you, but you are compelled to properly have oversight.

And because of that, I would like to tell you just briefly about Texas. And then about, in my judgment, if I were assessing State regulators, I would want to know about their ability to assess what the problem is. To see if that is part and parcel, an intelligent way to regulate this massive fiber of commerce.

Also today, I will be addressing my remarks to liability insurance.

Texas has a three-member board. It is the only State in the country with three full-time members. We have about 850 people that do nothing but regulate the insurance industry with roughly around a $35 million budget.

I will say to you that, in my judgment, we are seeing—we are going into the ninth cycle of what we are perceiving as—and there are two or three forces that are colliding with each other. One is the normal insurance economic cycle. Insurers do what they have done so well for the last 100 years, and that is compete themselves into the ground.

They have been—insurers have been irresponsible. They have been undisciplined. They have been—they have entered into massive cash-flow underwriting. I operate off of the axiom that their greed will always overcome their fear. And it has, in fact, happened again.

This cycle has been exacerbated, in my judgment, by two or three things. First, I was in the legislature in the mid-1970's when we dealt with—in Texas—when we dealt with the physicians, and a little bit with products liability toward the late 1970's.

Everyone was convinced that the insurance industry was ripping them off. And the business community, especially the larger corporations that had the financial ability and the capitalization, began to do things with Treasury. A couple of IRS opinion letters were issued and we saw a great migration offshore to the Grand Caymans, Bermuda, the Marshall Islands, the Isle of Sark, mailboxes on little bitty bays and estuaries, and massive drains from the normal rate regulated or regulatory mechanism in this country.

Because of the Treasury letters and the IRS opinion letters, there were certain tax benefits for major insurers to self-insure, or to form captives, as they have become known. I will submit to you today that that phenomenon has greatly past, and generally only the responsible ones that are well capitalized are left.

And it is very important what you keep in mind that migration to the offshore captives did because what it did was, it created a new capacity of reinsurance, the ability to assume risk in these very volatile, very highly exposed lines of insurance. We have the traditional international reinsurance market, and then we have the offshore captives.

And they formed essentially, what we refer to in the reinsurer's world as new entrants into the marketplace, not tested, not timely proven, but again, providing more capacity, more ability to cede risk, or to place risk, or to ensure insurers against themselves, and to retrocede risk.

Then along about 1980 we saw 20 percent interest rates, 15 percent—between 15 and 20 percent interest rates for about 2 or 3 years which in turn became massive embedded yields.

And that National Association of Insurance Commissioners—Texas, I will only speak for—I suspect that we probably—we are a highly, highly rate regulated State. Probably the most rate regulated State in the country. We began to treat investment income directly into the rate base. Even today, we treat investment income directly in the rate base, whether we promulgate the rates, or whether they are simply filed with us.

That new capacity and those high interest rates with those offshore captives, and then a phenomenon that began to grow. And that was, in the mid-1970's we saw doctors, generally health care providers, in trouble. And the hospitals and the doctors got in the business of insurance because they were convinced that they could do it better than anybody else. I voted for those bills, I might add—insure themselves.

Today, around the country those people are the first ones that will tell you they have enjoyed just about as much of this as they can stand, because they are in the insurance business. And they cannot find reinsurance capacity. And they come before my agency and testify for rate increases, the associations, that is.

What we are seeing today, what you are seeing today, we have been seeing for about 2½ years. Politically, I know that your doors are being hammered up one side and down the other; ours are too.

There are certain notions in our culture where you have got, one, the economic cycle of the insurer. And then you have the notion of entitlement, that for lack of a better term is what I call it. That has somehow moved into our system of jurisprudence. This notion of entitlement, I think, has begun to manifest itself in a lot of different ways, and it probably—probably, basically through the court system.

I am not going to get too much into that, Mr. Chairman and members, unless you want me to later on.

It is, in our country nationwide, I think—I know in our State—our State legislature dealt with the issue of DWI, with alcoholism. Properly so, it is a legitimate and compelling interest of a body politic to deal with fundamental social issues.

Correspondingly, with that education came some uncertainty in the system relative to litigiousness, relative to unpredictability. And correspondingly, the insurer began to see pretty—I would say fairly large amounts of litigation relative to liquor liability.

We dealt with the social problem. We have a corresponding economic concern.

Child care. Thank goodness in this country we socially, through our media and through education have dealt with the issue of child molestation, child sexual molestation, familial sexual molestation. But it has correspondingly moved into the area of the day care area, where there is such a consciousness about that.

So we have dealt with one social problem, but correspondingly we have had a response.

Look at the banks and savings and loans. I am on a bank board. If anybody at the corporate level sits on any board, you are finding trouble getting D&O coverage.

Mr. SIKORSKI. About day care, it is my understanding there has never been a claim filed.

Mr. OLSON. There have been claims filed.

Mr. SIKORSKI. Where? On sexual abuse in a day care center.

Mr. OLSON. I am not—I cannot give you a specific right now, but—and let me hasten to add, I think the point that you are making is well taken. And that is, where are the claims that have been filed? And I think that—and as I finish my testimony—I will point out a fact that the reinsurance mechanism essentially is driving this.

Mr. SIKORSKI. A recent survey of the International Association of Education of Young Children found that 9 out of 10 child care programs surveyed had never had a claim on their liability policy. Of those with claims, 75 percent reported claims under $500, and none were child abuse allegations.

Mr. WASHBURN. But the exposure is there.

Mr. FLORIC Why don't we permit the witnesses to finish and then we will go in-depth on some of these points?

Mr. SIKORSKI. I thank the chairman.

Mr. OLSON. And, Mr. Chairman, I will certainly be happy to respond. There are some specifics in Texas that were testified to last week and I can get those for you.

You begin to see banks, savings and loans, restaurants, long haul truckers, environmental pollution liability coverage, the lack thereof. And then you begin to see different courts doing different kinds of things. And resultant of that is that you have got a degree of unpredictability.

The international reinsurance market is saying that—and the insurers will say, our rates are not adequate. That is not the regulators problem. The rates are inadequate because they competed themselves into the ground.

It is not the matter of us not giving them adequate rates. We are having to raise rates—at least, in Texas we are—and properly so, for solvency reasons. But the reinsurer did the same thing that the primary insurer, and the retrocessioneer did the same thing that the reinsurer did. And that was that they assumed the risk for the cash flow for the high interest rates. As interest rates began to come down, embedded yields began to fall off, the chickens came home to roost, and the reinsurers said, we are out of the business.

I have been to, in the last year and-a-half, I have been to Tokyo, I have been to Russia, I have been to China. I have met with all the reinsurance folks. Every 2 weeks I am in touch with about

seven syndicates in the London market, both in Lloyd's and in the London market.

I have been to the Philippines within the last 4 months meeting under the auspices of the United Nations Conference on Trade and Development, meeting with the Asian third world developing countries relative to reinsurance.

I just got back from Israel last week. And I started to bring with me today, on the front page of the economic news of the Jerusalem Post a week ago Friday, the headline was, reinsurers withdraw from Israeli market.

It is an international problem. And if I had to tell you, Mr. Chairman, the one driving force is the irresponsibility, the undisciplined attitude that the underwriters have taken through their cash flow underwriting, their greed overcoming their fear. I think now their fear has taken hold, and the primary mover today, I would submit to you is the international reinsurance market.

I am sure that you will probably want to follow up with specific questions relative to it.

[The prepared statement of Mr. Olson follows:]

TESTIMONY

LYNDON L. OLSON, JR., CHAIRMAN,

TEXAS STATE BOARD OF INSURANCE

It is an honor to appear before you today.

I am most pleased to join my colleagues --Jo Driscoll of Oregon, Ed Muhl of Maryland and Bill Gunter of Florida--in discussing with you some very serious problems in the area of liability insurance.

These are problems with which I have become all-too-familiar in our state--and which I have spoken about and written about at great length during the last several months.

A crisis atmosphere surrounds the insurance industry today.

The industry's cries of pain have been heard throughout this country. Companies have gone out of business, and others are on the brink.

Consumers are hurting, too. They are hurting bad, and they have let us who regulate the industry know about it in no uncertain terms.

All of this, of course, is not altogether unfamiliar in a cyclical business known for its periodic up's and down's.

There is good news and bad news to bring you today.

The good news is that the crisis appears to be easing in some respects.

The bad news is, that for some, it may get worse before it gets better, and sweeping changes are going to be required in the interest of economic stability for this nation.

The insurance industry's problems mirror deep-seated and alarming facts about our society and our culture at large.

Most of these problems concern the property/casualty field-and particularly commercial property and general liability lines of insurance.

Business and professional people all over America know this scenario very well, indeed:

--Many are faced with 200 per cent, 300 per cent, even 1,000 percent jumps in premiums for less coverage than they had last year.

--Others have seen coverage in "risky" lines of liability cancelled at mid-term, or they have been denied renewals on short notice.

Key problem areas, where prices have soared out of sight, or the market has constricted sharply include:

Commercial multi-peril property insurance (apartments, office buildings, townhouses), environmental liability (toxic waste, etc.), directors and officers financial liability, municipal liability, child care center liability, medical malpractice liability and products liability.

Workers' compensation is also a disaster area, and attorneys, accountants, architects, even ministers, have joined the doctors in lamenting the cost of their professional liability coverage.

The property/casualty industry is reacting to an unbroken string of underwriting losses dating back to 1979.

The climax came last year, when the industry's losses from the business of writing insurance policies plummeted to a record $21.3 billion. Even with investment income, pretax operating income was a negative $3.8 billion. Net income after tax was less than $1.5 billion.

We are seeing a sharp increase in insurance company failures. Our list of companies in receivership in Texas has lengthened to about 75, and others are on the brink.

National Association of Insurance Commissioners examiner teams identify more than 200 life companies and as many property/casualty companies as "in need of immediate regulatory attention." that means they flunked four or more test criteria and are in danger of becoming insolvent. And nearly 350 others are borderline and need to mend their ways.

Insolvencies get very big very fast. Regulators must move faster and more firmly, and their tools must be equal to an age of massive computerization. Examiners with No. 2 pencils and green eyeshades can no longer keep up with industry development--in insurance, banking or other modern financial institutions.

The insurance industry historically operates in a boom-bust cycle.

That is a demonstrable fact.

The cycle is, in part, a symptom of irresponsibility and lack of discipline. It is, in large part, the result of sheer greed. Recovery from the bust end of the cycle--<u>and that's</u> where the industry is today--begins when <u>fear</u> overcomes greed.

In boom times, companies compete themselves into the ground.

So it was in the expansively-prosperous 70's.

Insurance companies eagerly priced their products at bargain basement levels to attract more money for investments.

As long as interest rates were soaring, cash-flow underwriting prevailed. There was a helter-skelter race for premiums and market share.

Then, as we all know, interest rates faltered and dipped. Last year, for the first time since the current cycle began, the investment income of insurers did not overcome the underwriting losses.

Now, we see the industry--trying to extricate itself from its predicament--again hiking its prices and, where it can, getting rid of marginal business any-which-way.

Historically, the nation has seen these scenes played out for a hundred years--with varying degrees of severity.

Today's trauma for insurers has been exacerbated by several factors.

--The phenomena of the late 70's and 80's included new forces: massive environmental disasters (such as escaping toxic wastes), previously little known industrial diseases (like asbestosis, silicosis and others) and rampant child abuse.

--Concurrently, and inescapably related, the litigation explosion developed and intensified. People began suing each other over every conceivable kind of injury or wrong.

They sued for medical malpractice, product failure or imperfection, job injuries or illnesses that did not develop for a decade or more after accident or exposure, hair dryers that singed as well as dried, autos that burned on rear end collision.

--As plaintiffs won on more and more liability issues, judges and juries became increasingly generous with awards. Multi-million dollar verdicts became commonplace.

--All of this contributed to another complication of global proportions--a crisis of capacity in reinsurance.

Reinsurance has been compared with bookies laying off their bets It is a form of insurance for insurance companies--a mechanism for spreading risk more widely by enabling one insurance company to assume part of a major obligation written by another.

Few understand reinsurance. Without it, the insurance business, as we know it, could not operate.

Primary insurers retain only a small portion of major risks--say 20 per cent--and reinsure the remaining 80 per cent in the international market for a premium. Reinsurers, in turn, keep perhaps 40 per cent and "retrocede" the rest at lesser premium to other reinsurers and investors.

Sixty-five per cent of the reinsurance in this country is obtained from the London market.

Lloyd's of London Chairman Peter Miller has warned repeatedly during recent months that world reinsurance markets are increasingly wary of business bearing a "made in America" label.

Insurance companies and their reinsurers are in the dark as to how our courts will interpret policy wording. Therefore, says Mr. Miller, they are unable to project with any certainty just what they are accepting liability for.

THERE widespread concern with lack of limits to liability and excessive awards by juries. A drive for major reform of tort laws dealing with injuries or wrongs to individuals is being mounted.

Serious efforts are underway at state and federal levels to place limits on liability.

Meanwhile, reinsurers are saying this to us, quite bluntly:

"Unless changes are made, we don't want your business anymore. We don't know what your rules are."

And they are talking about taking their investment to other countries, like Japan, where risk is more predictable.

The significance of this, of course, is that, where reinsurance is not available, insurance companies simply cannot afford to accept the largest and riskiest of risks.

Who can, single-handedly, insure a Bopal, a Love Canal, toxic waste, a nuclear explosion?

I am an insurance regulator--not a social architect...I am no longer a legislator, although I once was a part of that process and still have a deep empathy for it.

It is not my business to take the plaintiffs' bar to task or to take up arms with the tort system reformers.

As a citizen, however, I cannot ignore the impact on the nation's economy of spectacular increases in punitive, non-economic, non-injury related damages.

As both an insurance regulator and a citizen, I must take notice of the fact that insurance companies, partly due to an unpredictable judiciary, are now refusing to provide financial protection for certain types of business.

Some, caught in the dilemma of availability vs. affordability of insurance, have turned to self-insurance, but with varying degrees of satisfaction--and adequacy. The risk for smaller firms is high.

Captives, mechanisms formed by firms to meet their own insurance needs, are risky, too, and have brought losses to many companies that experimented with them in the '70's.

A variety of "rescue" proposals have been proposed in the states, where insurance regulatory authority rests.

--Voluntary market assistance programs have been proposed in New Hampshire, Pennsylvania and Illinois to increase the availability of coverage for commercial risks.

--In Illinois, Gov. James Thompson has signed legislation prohibiting arbitrary or unilateral cancellation of casualty insurance (with certain exceptions).

--Commissioner Evans in Georgia has issued a directive requesting commercial lines insurers to give policyholders 60 days notice of non-renewals or renewals contingent on steep premium increases.

--In Ohio, Gov. Richard Celeste approved an emergency regulation prohibiting cancellation of certain types of policies.

--In New Jersey, Gov. Thomas Kean issued a 90-day order requiring insurance department approval before companies could cancel liability policies for municipalities, schools and businesses; and the state's superior court of appeals rejected the insurance industry's plea to revoke the order. It has now expired, but I understand a permanent regulation restricting cancellations is contemplated.

In such times, there are always those who would turn to the federal government for the answers--for new regulation.

I am not among them. At this point, I see no need for federal intervention.

Federal regulation has merely complicated problems in other areas of business. It has not prevented 106 commercial banks from failing this year. In banking, obviously, federal supervision has been no guarantee of solvency for the smallest or the largest institutions.

The states continue to believe that regulation is best when it is closest to the people.

State regulators of insurance, however, are constantly assessing ways to improve their operations and to provide greater safeguards.

On the other hand, the federal government is responsible for determing if we are discharging our duties adequately.

In our culture, we have attempted to insure ourselves against every peril known to man.

Because insurance is identified with human needs and the quality of life, consumers and the framers of public policy have looked to it increasingly for solutions to society's major ills. In a sense, the insurer has come to be expected to pay for the social conscience of a nation.

At times, certainly, insurance has been called on to perform functions no longer consistent with the pure private enterprise approach--to provide services which even violate sound business principles.

This phenomenon is reflective of a broader pattern in our culture.

For two decades, we have been witnessing a social development referred to by some as the "psychology of entitlement." That notion is based on a concept of a world in which everyone is <u>entitled</u> to good

housing, good diet, and good jobs, good pay, good health care, good pension benefits--all as a matter of right, and without regard to ability to pay.

Today, people are beginning to realize the cookie jar is not bottomless.

In spite of the theory of "entitlement," we do not live in a risk free world, and we never will.

"Until the day when our institutions can be trusted to serve us as fiduciaries and when we can be educated to understand the limitations of the world we have constructed, litigation will remain the hallmark of a free and just society," wrote Jethro Lieberman in his book The Litigious Society.

Victims of negligence, suffering, tragic experiences deserve economic recompense. Litigation must always be relied on to resolve difference between parties. But the system must not lose its sense of reasonableness. And litigation must not be permitted to have an adverse impact on society.

There are signs of a let-up in the property/casualty insurance crisis.

--The industry has raised $[illegible] billion in new capital this year, and its stock prices have jumped 22 per cent since mid-1984, compared to a 10 per cent rise in the Dow Jones industrial index.

--Higher rates are being implemented in problem lines, and there is evidence of a return to discipline in underwriting, new marketing concepts and practices and expense control.

--Insurers are rethinking their priorities--and placing the business of insurance ahead of investment.

--Companies which have maintained their discipline and their strong loss reserves remain on solid ground.

Hopefully, in another year to a year and a half, the market will have righted itself and regained its strength. But some types of coverage may never again be available--and certainly not at the old prices.

Mr. FLORIO. Thank you very much.

Mr. MUHL. Mr. Chairman, Commissioner Gunter from the State of Florida.

STATEMENT OF WILLIAM D. GUNTER

Mr. GUNTER. Mr. Chairman, members of the subcommittee, ladies and gentlemen. Thank you for the opportunity to briefly address this body on issues of vital concern to consumers and business people, to municipalities and nonprofit agencies across this country.

The rising cost and scarcity of commercial property and liability insurance threatens the survival of large industry and main street businesses throughout the United States. The causes of this crisis include recent natural disasters, increasing litigation, and higher jury awards.

As you recently noted, Mr. Chairman, insurance officials and State regulators have frankly admitted, the insurance industry itself is in large part responsible for the current crisis. That is a view I share.

You have also mentioned that many have reservations about the ability of the States to deal with this crisis. We in Florida are keenly aware of our need to meet this challenge, because we would prefer to keep the responsibility of the regulation of the business of insurance at the State level. And I strongly feel that we and the other States can discharge that duty effectively and in the public interest.

In north Florida, in Congressman Don Fuqua's district where I grew up, it used to be said about medicine, that you do not take any medicine until you have tried it out on the cat. One of the good things about State regulation of insurance is, we get to use each other as the cat from time to time.

Florida, as you know, is getting ready to consider a very serious regulatory approach in our legislative process, and I think we have a good chance of passing it. Perhaps that makes us the cat I spoke of. But I have confidence that the medicine we are about to try is very good for what ails us.

This crisis has occurred repeatedly in the past. In 1976, the year I was first elected insurance commissioner, insurance costs and availability was a visible national issue. In succeeding years we in Florida were able to successfully address problems in private passenger automobile and workers compensation insurance.

In 1981, the year Congress passed the Risk Retention Act, allowing corporations to form captive insurers or group insure for product liability coverage, my staff and I were drawing up legislation to deal with some of those same problems in commercial liability insurance at the State level.

Our effort failed. Concern on the part of policyholders was low at that time because by then insurance had been stable and cheap for a few years.

And then last year, of course, we began to experience rate increases so steep, nonrenewals and cancellations so numerous in many sectors of the Florida economy, that a lot of Floridians became concerned for the economic well-being of the State. Past ex-

periences did not prepare us for the scale of this most recent market swing.

In order to learn more about the practical effects of the crisis, and to get the perspective of the commercial insurance policyholder we held hearings across Florida, and asked people to tell us their experiences.

We were impressed by three trends above all. The sheer size of the premium increases, the frequency with which premiums were raised or policies terminated, virtually without notice, and the numbers of policyholders with little or no losses whose insurance was canceled or who had to pay these tremendous increases.

We have long been aware of the irresponsible practice of cashflow underwriting. But we now see even more harmful and irresponsible actions by the industry making up for their past mistakes. The problem is deeper than just industry losses. It is a problem of the insurance industry's lack of commitment to fairness and consideration for its policyholders.

Frankly, I am concerned that commercial insurer's lack of sensitivity to the problems of the insurance buyer may well cost them their credibility with the public for years to come.

In drawing up legislation to deal with this crisis in Florida, we used three different but complementary approaches. In rating, consideration of surcharges and credits, notice requirements and windfall profits, we took a strong regulatory approach.

On the other hand, in opening up self-insurance and group insurance and encouraging risk management and investment in reinsurance facilities, we took a deregulatory or incentive approach.

Finally, to create an underlying safety net for those who are mandated to carry commercial insurance coverage for statutory or practical reasons, we called for a joint underwriting association to act as an insurer of last resort.

Right now we are taking these issues directly to the business and professional people of Florida. I think you will agree, it is normally pretty hard to get the general public to listen to insurance problems sitting or standing. I think it is evidence of how serious these problems have become that people are filling rooms to give us their message and to hear ours all over the State of Florida.

A minute ago, I mentioned the provision in our pending legislation to stimulate reinsurance. We have sought to do this by opening up to financial institutions the right to invest in or to own reinsurance companies.

While I believe we in the State can do much to stimulate capital flow to this area, there is a role which only the Federal Government can play. In effect, to water the roots of the reinsurance system. Let me give you an illustration.

A few years ago, the Insurance Exchange of the Americas was established in Miami. Since then, it has grown rapidly to become a valuable reinsurance resource. Twenty-three syndicates were authorized to conduct business in the exchange. Thirteen of them were set up as subchapter S corporations for the tax advantages they offered.

Since those tax allowances were eliminated over a year ago, no new syndicates have been formed, and 2 of the 13 syndicates are

inactive due to the loss of the favorable tax climate. This clearly shows the critical effect of tax laws on insurance investment.

There is also a need for Congress to explore ways to remove restrictions that might prevent federally regulated financial institutions from investing in reinsurance facilities.

Mr. Chairman, as I have indicated earlier in testimony to the House Judiciary Subcommittee on Monopolies and Commercial Law, I oppose repeal or modification of the McCarran-Ferguson Act. The States should regulate the insurance industry.

However, I believe it is abundantly clear that the Federal Government retains the power to subject insurers to Federal antitrust laws if they have engaged in conspiracy, boycott, coercion, or intimidation. In these areas, the Federal Government clearly has jurisdiction.

As a former Florida legislator and U.S. Congressman, as well as insurance commissioner, and a former president of the NAIC, I have had a lot of opportunity to deal with insurance issues from both the Federal and State perspective. My experience leads me to strongly urge that Congress continue to respect the traditional role of the States in the regulation of insurance.

As States work together, sharing information and experience, through the NAIC and otherwise, so can the States and the Federal Government work together in their respective roles to solve the problems which now beset the buyers of commercial property and liability insurance in America.

Thank you.

Mr. FLORIO. Let me express my very genuine appreciation to this panel for making very complicated things understandable.

It is particularly helpful for me—and I think I speak for the rest of the members—to have your views on this subject that this committee has not really gotten into up until the last few months in any great depth. Because, as you all know, there has been no particular need for us to get into it. But I suspect there is a need for us to, at least to educate ourselves, and to reassess how the system is currently operating.

I think what we will do, in light of the attendance, as well as the complicated nature of the topic, adhere to a 5-minute rule, which is on us, not on you, in terms of our questions. And we will have rounds of questions.

I have some questions that I would like to go into. But before doing that, I would like to ask just some general things about what seemed to be a similarity in your comments.

For example, you all appeared to be saying that cash-flow underwriting exists. It is there. It is not desirable. It appears to be a recurring feature of the business cycle in this industry. And yet, you are the ones that are charged with overseeing the well-being of this industry, from the standpoint of the industry as well as consumers.

What is it that you were doing, if anything, at the time when this pricing was taking place? Do you regard it as beyond the scope of your regulatory capacity to do anything? And if it is, do you feel the need to advocate legislative changes at the State level to provide you with some capability of regulating in accordance with payout or anticipated payout in the setting of rates?

Mr. MUHL. If I may, Mr. Chairman, I think we were all involved in that process and very concerned about the cash-flow underwriting. But let me suggest to you that there are some factors that were controlled factors and others that were totally uncontrolled by either the regulator or the insurance industry themselves.

We were taking into consideration the investment income, and we were trying to balance those interests. And I think you alluded to it earlier in a previous conversation, that when you have high interest rates, there was a chance of gouging the public if the rates were not reflected lower. So that was a concern of the many regulators.

And in my State—and I thought for sure they were going to commit me to a mental institution—I ordered two of the companies to increase their rates in a situation where I thought their solvency was in jeopardy. A very difficult situation, particularly when you are sitting there with a lot of insureds and you are telling them, we think you ought to pay more for insurance.

Mr. FLORIO. But you are telling us you do not think there is the capability of evaluating the three components in the ratesetting process, income off of investments, as well as income coming in from premiums, as well as anticipated well-priced premiums for anticipated payouts?

Mr. MUHL. No; I am not suggesting that. What I am suggesting is that, yes, we can have a control in that area. But when you are dealing with a lot of these factors, you are talking about an insurance company having a lot of this then ill-priced business on the books, making up for the deficits with the cash-flow coming in.

Mr. FLORIO. No; I am talking about the process that takes place at the point where you have this sequence of events. High interest rates—obviously, some benefits from anticipated investment income. And then someone is competing for the dollar, so as to get the benefit from the investment income at that time.

And then making the decision that you want the dollar more than you want the prudent, fiscally conservative pricing of the product. That appears to be a factor that you acknowledge takes place.

Mr. GUNTER. Mr. Chairman, I think clearly in some States, we are going to need additional legislative authority in order to be able to do the job, to set certain standards with respect to the ratemaking process. That is what I was trying to allude to in my comments.

Because, candidly, in our State there is a standard written into the law by the insurance industry which says that you must establish that there is no effective competition in commercial liability and property insurance. And the burden of proof of that is on the insurance department.

If you have basically got a couple of companies that are offering coverage, of that kind, even though both companies may be charging excessive rates, it is difficult to get past that particular standard.

Mr. FLORIO. What you are saying is, the assumptions that competition will work out in the interest of the company is put into question because you can have the competitive forces working to drive the companies under as a result of inappropriate pricing.

Mr. GUNTER. Absolutely. It works both ways.

Mr. WASHBURN. The problem, of course, is that you have got to make assumptions on how long the interest rate is going to be there. For example, I think if the interest rate were up 7 percent from what it is today, we would not be in this crisis. They would have been all right.

And there were assumptions made at the time that they were pricing this product, that indeed, interest rates were going to stay up for a number of years. It is when the interest rates started to decline and their prices did not come up that they really started—it got a little bit more difficult to price the product.

They are seeing losses now from 1981 and 1982. They have not seen 1983 and 1984 losses to a great degree in terms of what is coming. They anticipate it coming.

The other problem is, that competition happens in all the lines. It happens in property. We do not have these fluxes in the property insurance. We have some fluxes. Last year there were increases in property insurance, commercial property insurance rates.

The problem is the ability to anticipate on the long haul. Casualty takes so long to know whether your price was correct, even for the companies, because you have got to track what is going on in the courts, that is driving you, what may go on in the courts, how the payout is going to be in several different years. And that is a very difficult rating process for the companies to do, much less the regulator.

Last, but not least, to monitor exactly how rates are going. People do not come through your door and say, you know, they charged me too low a rate last year. That is not one of the things that people were coming to talk to us about in 1982 and 1983.

Mr. FLORIO. But that does not mean it is not one of your responsibilities when you see those things, which you obviously have seen, to do something about it then.

Mr. WASHBURN. You see it on an aggregated basis. You say, your loss ratio is very high, much higher than it should be. But to try and go out and say, for this business your rate should have been higher, you start to do the underwriting.

I mean, what you do is establish, for States that set rates—and Illinois, by the way, does not deal with rates at all—for States that set rates, they set a rate. They say, this is what ought to be charged. But individually, companies may vary off of that rate, because the risk is better, they have a different type corporation.

It is very difficult in commercial insurance, because it is like buying a car. What all have you bought? Do you have pinstriping? I mean, it is really an individual basis when they start determining what they are going to charge.

Mr. FLORIO. This is a matter of mechanical information for us. Do you each have the capability of oversight as to underwriting standards? I mean, do you in fact, when someone comes in and says our price is this and we have used this standard to anticipate that it is going to be sufficient to cover anticipated losses.

Do you ever, either randomly or on a regular basis, review the adequacy of the underwriting decisions that are made by the companies in pricing their product?

Mr. WASHBURN. In Illinois, we do not do anything with rates—we do not have any rate setting at all, rate looking in law. We have gone into individual companies, usually in the personal lines area where you have got a better idea of whether there price is adequate.

When you see someone out there trying to buy a market, that is clearly below everyone else, and everyone else is very marginal. And we have gone in and said, this rate is clearly inadequate. If you do not do something, we are going to do something about it.

But it is much more difficult to do it in the casualty line because—especially commercial, where the businesses vary so much, and you have got to go through every piece of how it was underwritten to come up with an answer.

Now I think some other States probably have a different method because they are much more into ratemaking than we are in Illinois.

Mr. OLSON. Mr. Chairman, I think one of the things that it is important to understand is that, for instance, you just heard from Illinois that has no rating system. Texas has an immense—the most immense rating system in the country.

We set a maximum rate in a number of lines, and individuals come in—individual companies come in and deviate off of the maximum rate that we set.

There are seven or eight people that sit in a particular office on the third floor at a particular address that have faces and make judgments about whether that deviation, from a solvency standpoint, is justified. They talk to the stock analyst, the bond analyst, the securities analyst, and primarily the examiners, of which we have right at about 172. And the examiners assess the financial viability of that company and then go ahead and either approve or disapprove the rate.

As a practical matter, I doubt any of us would be sitting here today if the rates were not—if you did not have the availability problem and the affordability problem. It is something that you do not—it is difficult for a businessman to accept, and I respect that and understand that.

For the last 5 or 6 years, you heard nobody complaining about their insurance rates, in the aggregate, because they were at rock bottom. I mean, literally the insurers were giving the stuff away.

Politically, my legislature, our board, my Governor did not hear a word from anybody, because it was the greatest deal in town. Then all of the sudden, no one knew what had hit them, and it hit them, and rates went up from 100, to 200, to 300, to 1,000 percent, if they could get it.

But I do think to some degree it varies by State. We have in several lines acknowledged that the rates were too low. And frankly, put a floor, forcing those rates back up.

Now we have the regulatory ability to do that in Texas. I do not like doing that. I do not like to interfere with the normal market cycle. But the insurance industry, unlike a utility, is so immensely competitive that I think you have to do that.

And some of us would differ here as to—I mean, you have got totally free, open market States represented here. Then you have

got the extreme in Texas that is so highly regulated, although there is fierce competition.

Mr. GUNTER. Mr. Chairman, our approach in Florida would be at the middle ground, I think. You have Illinois that is free and open. You have Texas that sets rates.

And our approach would be a use-and-file approach, where the companies actually could employ a new rate, could put it into use and then file it with the State insurance department thereafter. At which time, our actuaries, accountants, and staff would go over it with a fine-toothed comb. If it is unjustified, the proposal calls for the ability to order a refund between the difference in the acceptable level and the level being charged by the commercial insurance carrier.

We think that is vital, because of some of the horror stories that we have run into where we call into question the credibility of rate increases of 500, up to 1,000 percent.

And certain classes of business, which have been alluded to in this testimony, day-care centers, for example. We had a group of them in south Florida recently, and there were all kinds of experiences where companies had been in business 11 years, 18 years with no losses. We had just passed a strong regulatory law in Florida with reference to the operation of day care centers.

But what you see is, because of some well-publicized stories of child abuse in one or two or whatever of these type operations, frankly, the insurance industry raising rates out of the roof, not specifically in keeping with the experience of that type of business.

Mr. FLORIO. Mr. Lent.

Mr. LENT. Thank you, Mr. Chairman. And I want to welcome and thank the witnesses for their testimony today. I would first like to ask our formal colleague and an old friend of mine, Bill Gunter, a question. You stated that the Florida Legislature is going to consider legislation shortly to address this affordability and availability problem that we are discussing today. Can you give us any elaboration on what types of legislation is under consideration by the Florida Legislature?

Mr. GUNTER. Congressman, the approach that is under consideration would encompass, as a keystone feature, the ability to review the rates used and filed with the insurance department, including the system of surcharges and credits.

For example, today many of the companies do, in fact, file their rates, but then they utilize surcharges and credits applying them to the rate levels, so that the bottom line premium charge which the particular company charges its customers is not known by the insurance department. There is no real effective way then for oversight.

Mr. LENT. Bill, my time is limited. Do you contemplate any changes in the tort law in Florida as part and parcel of this?

Mr. GUNTER. Yes; there are several legislative initiatives in the tort reform arena that will be developed. My concentration in the insurance department has been on the insurance marketplace and the insurance mechanism itself.

Mr. LENT. Does the bill, that you have mentioned before, let the banks invest depositor's money in reinsurance plans?

Mr. GUNTER. It is indeed. And bear in mind, we are limiting it to the reinsurance area, because we think there are possible abuses with respect to the standard buying and selling of insurance. But in reinsurance, we think that opening up that option to the financial community to make such investments will help the industry, as well as will loosen a very tight market and help consumers.

Mr. LENT. Well, it just occurs to me that if Lloyd's of London is getting out of the reinsurance market because they feel the United States is an unstable place and they do not want to assume any risks here any more, are not the people who put their money into Sun Bank and Barnett going to be at risk if their money is being deposited by their bankers in, or invested in, reinsurance schemes?

Mr. GUNTER. Congressman, I think frankly, if we can learn from past mistakes, and if we can understand that you have to charge an adequate premium for the risk assumed, that now is a good time to get into the reinsurance field.

And I think, of course, obviously as occurred in the savings and loans field in recent years, you have a situation where some entities like Lloyd's of London have gone through very tough loss experiences. And they are saddled with that. They have got to deal with that and compensate for it.

But a new reinsurance operation, if they can learn from that type of mistake, can be very successful.

Mr. LENT. I would just like to, if my time permits. ask Mr. Muhl, a question. In your testimony, sir, you discussed the broad interpretation of narrowly defined and limited insurance contracts. The result of these interpretations is that insurers are being required to pay for risk exposures they never intended to cover. What action is being taken or considered at the State level to address this problem, such as the negotiation and adoption of the claims-made policy?

Mr. MUHL. All right, well, that is one aspect. The other is to—and I think Commissioner Olson alluded to it earlier—and that is the entitlement attitude. In order to change that, you have to change the system. The only way you can change the system, in our opinion, at least in the State of Maryland, is to place some sort of limitations on the systems.

The limitations that we are considering presently, and the Governor has submitted a package of reform bills, and that is to put caps on noneconomic damages. To modify, if you will, the collateral source rule, all with the intent of making sure that if somebody is negligently injured in some form and fashion, that you restore that person back to whole, but you do not necessarily enrich them.

So there are several of these reforms, tort reform measures that we are looking at. Plus we are looking at alternative sources. The possibility of combinations of self-insurance and insurance. Then involuntary programs, as well, in addition to the tort reform measures.

Mr. LENT. You have said, at page 10 of your testimony, that there are risks that, "cannot and probably should not be insured." You seem to be referring specifically to pollution liability. Due to the inability to measure the costs of such risks, I understand why some risks cannot be insured presently. However, are there not

changes that could be made to the law which would make those risks insurable?

Mr. MUHL. Yes; particularly if you were to define, say either standards of negligence or specifically with reference to insurance contracts. Once they are established and you place some limitations on expanding or broadening those coverages, then, yes, I think a lot of those would become insurable risks.

The whole point being that if an insurance company—or even one who would go self-insured—if they could in some form and fashion measure that risk, they could place a value on it. But if you cannot measure it, it is impossible to price it.

Mr. LENT. Thank you, Mr. Chairman.

Mr. FLORIO. The gentleman from Minnesota.

Mr. SIKORSKI. Thank you, Mr. Chairman.

I, too, want to thank the panel for some excellent testimony and assistance in this complicated area. I would like to focus on this round on just one aspect, and play doubleduty as a member of the Select Committee on Children, Youth and Families.

We had hearings last summer on the problems child care providers were having finding liability insurance. We heard examples of well-established child-care programs which experienced insurance cancellations, and then now face 200- to 300-percent increases in premiums, even though there never had been a claim filed against those companies.

The select committee continues to receive similar reports from child-care providers across the country, and I know your experience in your States is similar. We have also learned that there have been no major sums paid out by the insurance industry for a claim made against a child-care provider.

I cited earlier a recent survey by the National Association of Education of Young Children which found that 9 out of 10 child-care programs surveyed had never had a claim on their liability policy. Of those that had claims, 75 percent reported claims under $500 and none were for child abuse allegations.

Maybe, if you do not have the specific information, or you can talk generally and then supply for the record the specifics, how many insurance companies are currently writing liability insurance for child-care providers, including family day care providers in your States?

And also whether you have State laws that require either family day-care providers, and/or group programs to carry the coverage. And whether the coverage of these companies differs from what it has been in past years.

Mr. MUHL. Mr. Sikorski, if I may just respond to that. Let me just identify quickly and briefly——

Mr. SIKORSKI. You testified at our hearings this past summer.

Mr. MUHL. I did, yes. The bulk of the day-care business is—it is a specialty market. It was written by just a few carriers. One primary one, Mission Insurance Co. Mission has sustained some severe losses for a lot of different reasons and having some difficulties in retaining certain reinsurance contracts. Ultimately having capital and surplus deficiencies. The company was recently taken over by its domestic insurance commissioner.

Mr. SIKORSKI. Were any of those problems related to claims on child-care providers?

Mr. MUHL. No, it was—no, not really. Because there was not a lot of claims or one massive amount of claims or volume of claims as a result of sexual abuse or child abuse of the kids.

But as I say, unfortunately, it was a specialty line. A very few companies wrote the business. And this company was placed into rehabilitation. It dislocated quite a few day-care centers throughout the United States. There were very few other carriers that were in this line of business.

Now you have your personal lines carriers, for the most part, who sold homeowner's policies that did have endorsements, commercial endorsements, on the homeowners to insure the smaller family day care. But very few companies had programs of writing the centers, because Mission Insurance Co. had a lock on it, for the most part.

Now you are seeing several of these companies coming back in. The one point I want to make is the insurance industry for the most part, has overreacted to a lot of these situations, as a result of being—or having solvency concerns and this fear that Commissioner Olson alluded to earlier.

They have not only withdrawn from some of the poorer markets, the ones that produce some heavy losses, but there is overreaction where they have withdrawn from some of the good markets as well, or have a reluctance to enter into some new markets until they can step back, regroup, and find out where they stand financially and whether or not they are going to survive.

There has been a lot of movement, particularly as a result of some of our market assistance programs throughout the various States—and the bulk of the States have those—where we have been generating some activity. There are a lot of companies, Liberty Mutual, USF&G, and some others who have indicated that they will write the day care folks through these market assistance programs. There has been a recent announcement that Continental Insurance Co. has put together a program to write day care.

The numbers of day care folks in Maryland, for an example—and I think Illinois has a similar number—that needed the insurance, that could not find the insurance, we had six applications in Maryland. Three of those were returned as a result of being able to find it in the private sector, so we have three remaining. If we cannot get those within the week, they will be put into the market assistance program and the insurance industry will accept those risks. Again, I think it is very similar as in other States.

The problem is being resolved, but you are absolutely right, there has been an overreaction by the insurance industry. They are just afraid to get into this, because this may be the next volatile area because of the massive amount of adverse publicity.

Mr. GUNTER. Congressman, I think I should add that in those cases where you have States that have passed laws requiring a certain level of liability insurance for day care centers and other classes of business, in my view, it is absolutely essential that you have an insurer of last resort. That you have a pool, participated in by all the commercial liability and property carriers that would provide an opportunity.

It is just inherently wrong that you pass a law and say, a day care center operation has to have liability insurance, and then they cannot find it at any price.

Mr. OLSON. Mr. Chairman, I do not know if with the time being up if I am precluded——

Mr. SIKORSKI. I cannot ask any more, but you can answer.

Mr. OLSON. But I can respond?

Mr. FLORIO. We are very liberal in that regard.

Mr. OLSON. I think you need to kind of keep in mind this 10-year frame we are talking about. Because it is almost lunacy to try to explain this industry to any rational human being because on the front end of this cycle, the insurers took the absolute worst risk at the absolute lowest price. On the other end of this cycle, the insurer is taking the—is not taking probably some of the absolute best risks that they have had for 20—it is not at all uncommon in Texas for us—or around the Nation. We have all sat and—we talk quarterly for a week about these things—to see a company, a good well-run company, well-capitalized, not very much exposure, to have been insured for 20 to 25 years by the same company, may have had one or two de minimis claims and were not renewed.

Now let me go out in the sequence of the insurance transaction and try to explain the phenomenon that is coming about. One, I talked a little bit earlier about the notion of child—of the social awareness that we have created in this country over the last 2 or 3 years about—relative to child molestation, child sexual abuse, and other things.

That has created in the mind of the underwriter, who is now having to be immensely disciplined, beware. And the way that a reinsurance agreement is entered into by a primary carrier, is that that insurer—I, XYZ day-care center, for instance—am insured by the Aetna—only because it starts with an A. And the Aetna assumes, say 20 percent of my potential exposure, or it could be any line of liability coverage.

The Aetna then cedes or lays off, if you want to, say 80 percent of my exposure into the international reinsurance market, or may lay it off in general liability in the domestic reinsurance market. That is done in a million different contractual ways, but it generally done through two kinds of contractual arrangements: a treaty arrangement, and a facultative arrangement.

And when that happens, XYZ Co. takes all of its liability risk, bundles them up, ties a string around them, puts them in a box and ships them off to some reinsurer. And is really not aware—I mean, if we went in and said, where is the ultimate retrocessioneer? Who ultimately on this exposure—even the insurer might lose track of that at some point.

But there is where a lot of the good risks—because the reinsurance capacity has tightened, the lack of capacity internationally to assume—and we are talking hundreds of billions of dollars in potential exposure.

I made the statement—Bob Hunter is a dear friend of mine—I made the statement to Bob the other day, he was advocating—I do not know if it was he or Mr. Nader—were advocating a Federal reinsurance mechanism. And my response was, if you like the Federal deficit, you are going to love Federal reinsurance, primarily be-

cause you are opening yourself up to exponentially immense amount of risk.

Now the serious risk like pollution, environmental, and municipal liability are risks that I think governments are going to have to deal with. But, you know, someone says—I have never had a risk. My father is a lawyer, has not had a claim. My brother is a lawyer, has not had a claim filed against him, practicing law in Waco, TX. And you know, dad's premiu . went up ridiculously.

My homeowner's insurance—I mean, it should not be any different. I was canceled midterm.

And I asked—they called the doctor who is the president of the townhouse association, and there are 20 of us. And this is the mentality we are dealing with. Call the doctor, he said, Lyndon, I am going to appoint you chairman of the insurance committee. I said, that is fine, I will handle it.

I asked the company, I said, tell me why. We have not had any risk or exposures or claims—one hail damage and that is all. And you know, we had a good experience, a great risk. They said, well, there has been a change in hazard because of your wiring. I said, no, that is not it. The change in hazard was, our rates are too low and you wanted to get off of that contract. And frankly, we just fired the agent and fired the company and got a new policy and our rates went up 23 percent.

But we were caught—we were put in that box with all those other commercial liability policies and shipped off somewhere. And it is that kind of market conduct that we are—you know, the insurers do not want to see us come in on midterm cancellations on the kinds of flagrant abuses such as that.

That are, in my judgment—and I will say this, and I will say it to the company, and general counsel of the company—there was not a change in hazard. The change in hazard was, they underpriced the product and they got caught in the middle of it. And a deal is a deal at some point. We recognize that there is some risks you should be allowed to get off of if there is a real change in hazard.

Mr. FLORIO. The time——

Mr. WASHBURN. Could I just add my 2 cents in? And truly, I do not want to speak for how companies rate policies. I think they ought to have to answer for themselves, and I think they ought to be made to answer for themselves.

But we have got to remember something about insurance. A, you have got to have in the group, people who have not had claims. They group risks. Some people are assumed to have no claims for years. They have the same exposure as others who have had claims.

In other words, it could happen to them, it just did not. And that is sort of the whole concept of insurance is, if you group enough people in the group, you will pass the costs of the claims around. That is the first thing.

In day care, because you are dealing with kids, the claims can be years away. I mean, the fact of the matter is, on today's policy, the claim could come in 5 years. And if they prove child abuse, if a kid gets hurt by another kid and they did not have adequate supervision, any of those sorts of new changes in the risk can multiply the

exposure of the insurance company both on that one and on anything else that has happened to this year.

And that is one of the problems with liability insurance is, how do you price today's policy for a claim that may not come in for 5 years. But you have got to understand that there will be prices increased for policyholders who have had no claims. That is the way the structure works. They have the same exposure, they just have not been hit this year.

Mr. FLORIO. The time of the gentleman has expired. The gentleman from Pennsylvania.

Mr. RITTER. Thank you, Mr. Chairman. I wonder, Mr. Olson, whether this insurance company, knowing the role that you play in Texas as State board chairman was simply getting even with you for something you did to them, years ago.

Mr. OLSON. I do not know. My response was, when—frankly, when I was called to be—probably like you all, the response was, but I wish—you should have told us. And my response to that, Mr. Ritter, was no, I should not have had to tell you. That could have been my grandmother, that could have been some unsuspecting human being, that could have been the little old lady in green tennis shoes down the street.

At some point you have—it is that kind of action that I think pours gasoline on the fire in that kind of cycle. And it is that kind of insensitivity—not because I was chairman of the insurance commission of Texas——

Mr. RITTER. They probably did not know you were chairman of the insurance commission of Texas.

Let me get on with my question here. I would like to go back to a question that was asked by the gentleman from New York, Mr. Lent. He talked about the testimony, Mr. Muhl, that you gave, page 10 where you said, there are risks though that cannot and probably should not be insured because of the inability to measure the cost of risk. I refer to pollution liability in its various forms as one example.

As changes are made and the liability system provides more stability, these risks will not be insured—unless changes are made and the liability systems provide more stability, these risks will not be insurable at any cost.

Now, that is a very, very strong statement, and it does encompass a fairly large segment of the economy of the United States. I mean, if you take all chemicals, if you take toxic torts, if you take the new laws that we are passing here, the pending Superfund law which opens up new potential for lawsuits, if you look at some of the recent environmental statutes enacted, it all points toward increasing pressure in the courts in lawsuits.

Now, has your association—has the National Association of Insurance Commissioners done a study in this area? Do they have a task group? Do they have a significant body of effort that seeks to understand where the structure of the law is going from the Federal Government imposed upon the States?

Mr. MUHL. We, in direct answer and brief answer—and maybe one of my other colleagues would like to elaborate on it—we have just recently formed a task force; a subtask force of one of our com-

mittees with the NAIC structure to review that very thing that you are talking about.

Mr. RITTER. Let me say that I believe you are very late.

Mr. MUHL. Well, we have been doing it in the individual States. We have been looking at it rather closely.

Mr. RITTER. But I am saying that this problem has become so acute to the point that you are talking about, unless changes are made and the liability system provides more stability, these risks may not be insurable at any costs.

You are talking about a sizable percentage of the American economy going uninsurable. I think the bottom line here is that there may be a need for more cooperation, more discussion, more interchange between the State and the Federal Government before the situations become so acute that we face breakdown, default.

Mr. MUHL. Absolutely. Because—you can even take that one step further. When you look at what happens on the State level with reference to passage of certain laws, how that ultimately affects some of the local jurisdictions, your municipalities and your counties, your police districts, if you will.

So it all has an impact, and you are absolutely correct, those lines of communications should be open to discuss these various problems. Particularly when you play these scenarios out to the fullest extent, how it ultimately affects it.

Mr. GUNTER. Frankly, Congressman, in the political process, as you know, sometimes it takes a crisis to get action. Because, we tried to introduce in the Florida legislative process back in 1982 some proposed changes that would allow our insurance department to move in these critical liabilities areas. But because of the higher interest rates, because of greater stability, less costs to the insuring public at that point in time, nobody was interested.

Mr. RITTER. I suggest, by the way, that your point is well taken. The pollution liability question is so unknown, the risks are so misunderstood. They have the potential for varying enormously. They involve very small numbers in terms of risk assessments; very small numbers.

You almost have to make negative findings that no such a risk can never occur, which is an impossible finding to make. And therefore, the finding is not made. And the numbers are small so that you cannot pin them down.

I guess, a very sincere effort on the part of your association, on the part of the task group of your association and getting back to us as soon as you can, because we are in this committee—I ask unanimous consent to proceed for a minute.

Mr. FLORIO. Please proceed. Finish your question.

Mr. RITTER. We in this committee are directly responsible for the laws that are setting up the structure within which the States and the municipalities are dealing with, and we are not doing this with the feedback from the grassroots. It sounds good in Washington and we go ahead with it; passes unanimously because it is pro-environment, it is procitizen.

But in the bottom line, it could be severely injurious to the enterprise.

Mr. OLSON. Mr. Ritter, may I take a shot at something that—I am not—I am a regulator and I am in that capacity, in my quasi-judicial capacity. Anyway, I am not a social architect.

But I sat as a legislator, and I have a notion that first, in these holy wars you get into in the insurance—in these kind of crises. You have got the plaintiff's bar versus the insurer, versus the business community, versus the world, versus anyone in enterprise or commerce that cannot get coverage that is either mandated by law. So you have these impregnable fortresses, political fortresses out there.

But as a human being, sitting, observing all of this as a regulator, one of the things I have observed is that I think we have had a collision in a point in time happen. I, for one, am not sure that you can quantify in numbers the effect of tort, which ultimately is a social action, the values manifested through a body politic at the local level, at the State level.

That tort is a reflection of the mores and the folkways of our culture, the change in tort. And I alluded earlier—I do not know if you were here or not—to this notion of entitlement. And it is merely this, an observation. But I make is because it does not fit in the regulatory cycle that I deal with, that we deal with daily.

But in our culture I think that we do have a system, rightfully so, for those individuals who are less fortunate and often poor, in the form of a safety net. It may be eroded from time to time, but we do have a safety net. The wealthy generally use the Tax Code.

But what I think we are seeing today is a middle fiber—and it will move out—that looks and says, that if today I am wronged, in this culture, I am automatically entitled to be made whole. I am a baby-boomer. It is my generation.

And the way we define being made whole today, is through economic compensation and remuneration. Now, I use this example——

Mr. RITTER. If I could just interpret for a second. What we are doing here though, in this body, in this Congress, in this committee, in this subcommittee, we are synchronizing that trend in society. We may not be dealing with it objectively, we may be part of it. So what happens is, we exacerbate that trend.

And if that trend is a dangerous trend, or it has unknown consequences which can be disastrous for the society, we have got to have a far better connection with those who impacted by the trend, like yourselves, coming back and saying, hey, look, you know, this thing that you are proposing is going to up the ante in a situation where the ante is already so high that the system is becoming dysfunctional.

And I think, again, I am getting back to page 10 of the testimony of Mr. Muhl, I think we are right in that crisis position on this area of pollution liability, toxic tort.

Mr. OLSON. If I might just finish by saying that in that tort system, that system of making someone whole, the insurance industry I would respectfully submit to you has become a mirror in our culture of the mores and the folkways of our culture. And that is being manifested through our system of indemnification in making someone whole.

And that kind of litigiousness, that notion of entitlement, that notion of reimbursing me and making me whole, the insurance mechanism—it has impacted the insurance mechanism. That was my only point.

Mr. FLORIO. The time of the gentleman has expired.

Mr. RITTER. I thank the gentleman.

Mr. FLORIO. The gentleman from Texas, Mr. Hall.

Mr. HALL. Thank you, Mr. Chairman. Members of the Texas delegation, incl·ding Congressman Fields, know Chairman Olson very well; he is ·ghly regarded and highly respected. He comes from many angles, and is not only knowledgeable and experienced, but he is practical. Lyndon, I think that you have given us some very good testimony here today.

I have heard it said that in 1985 we had earthquakes in Mexico City on one side of the Capitol. We had that bad coastal storm on the eastern coast, and in between we had Gramm-Rudman.

I have further heard it said that if Lloyd's of London should pull the plug—and you alluded to that on page 5 of your testimony where you said, 65 percent of our reinsurance emanates from the London underwriters—than Lloyd's would become the Gramm-Rudman of the insurance industry.

What are the facts on that, and have you addressed the fact that that might happen? And if so, what online procedures have you considered?

Mr. OLSON. Well, all of us, have Mr. Hall. I guess we all try to stay closely in tune with the reinsurers. It is kind of an esoteric industry, and you try. Maybe Lloyd's just happens to be the one we all refer to. It may be some sheik in Oman or Kuwait, or some Turk in Istanbul. The truth of the matter is, the Soviet Union through a Rumanian insurance company called Ados reinsures. Red China reinsures; Brazil; on and on and on.

Mr. HALL. But don't they follow the Lloyd's of London? Do they not set the tune?

Mr. OLSON. Yes, sir, I think that is a fair statement. What is happening is, even—let us assume that prices become adequate again. And I am going to make that assumption that they will. That is not to just be flippant and say, well, do not worry about this folks, we will ride it out and they will become adequate again. But I do believe, in the fullness of time, they will become adequate again.

Basically, what the reinsurers are saying to us in the United States is—and I am talking about all of us—and especially to us as regulators are, we know—we have done the same thing the primary carrier did. We competed ourselves into the ground because of high interest rates, and a number of other things.

But your system of tort—this is what the reinsurer is saying—your system of tort law is so unpredictable in the United States today, that we know what the price is when we get it, adequately, but you change the rules in the middle of the game through judicial edict.

And so therefore, the last thing that the insurer wants to know, or the first thing the insurer wants to have established is a sense of predictable. And that unpredictability is causing them some concern.

I will say this, Mr. Hall, before you slipped in, I visit every 2 weeks with a number of the syndicates in the London market, both Lloyd's and the London market. I have just returned from Japan. I met with about two or three reinsurers there and with a gentleman who would be their insurance supervisor. And frankly, these folks are in the business to make money. They have really—I mean, we ain't the only game in town in the United States.

And as the London folks will tell you, at one time, we in the United Kingdom thought we were the biggest dog on the street. And you know, they are looking to our system and they are saying, wait just a minute. You know, why should we not go to Japan? We are not going to get the kind of premium income that we are used to in the United States, but we do not have a very frustrating system or lack of predictability in the Japanese market.

So there is no reason for us to think that now that we lose capacity to a country such as Japan. And I think it is—when you look at the cycle, the economic cycle, this notion of entitlement through tort and a number of other things, you begin to see what that reinsurer out there is beginning to make his judgment on.

A good example of Japan was, in the tragic crash of JAL crash, there were 200-and-some-odd people killed. There were about three lawsuits, that were Americans. There were not any others.

And you know, we have to internally look in our culture and say, what is different in 1985 than in 1975 where you have got child care, savings and loans, banks, attorneys, doctors, lawyers. On my CRT in my own office, I have nine insurance companies that write nothing but pastoral liability.

Mr. HALL. Before my time runs out—you can talk all morning, but the chairman is going to cut me off. Let me ask my question. I am going to get to you, too, Mr. Washburn, in just a minute. Maybe I ought to ask 5 minutes worth of questions and then let you answer.

If Lloyd's should pull out—and by not directly addressing that, I am presuming that you think they are not going to, because they are in the market to make money. They think things are going to get better, and they are going to go to other areas.

So you think they are not going to pull out, but if they do, what do we do?

Mr. OLSON. They have pulled out to a great extent. They will reenter. They will not reenter probably as much as they have before. We will lose that. And at that point, I think that we have to look at alternatives.

In Texas, for instance, I am suggesting what Florida has, and what Illinois has, and New York has, and that is an insurance exchange.

Mr. MUHL. And we are going the same direction in Maryland.

Mr. GUNTER. And one of the areas, if I might add, Mr. Chairman, to the comments of the commissioner from Texas, that I think is very clear in this regard is, there is a need in the reinsurance market for an infusion of new capital. We need, on a long range basis, to look to our own domestic reinsurers to a greater and greater extent. We should not have to continue in this country to look to offshore or international reinsurers.

And that is why I am hopeful that the Federal Congress will look at the area of investment incentives in reinsurance. And also examine the current interpretation by the regulatory agencies prohibiting financial institutions with Federal charters from investing in reinsurers. We think that those sources of capital ought to be opened up—in Florida, anyway. I am not trying to speak for my colleagues up here.

Mr. WASHBURN. If I could just say, on Lloyd's, the brokers I have talked with—I have not—I do not know how the companies have had reactions. The brokers who place business through Lloyd's also for their clients, have told me that Lloyd's has not been the problem. But Lloyd's only takes, say 10 percent of the risk. It is trying to place the other 90 percent of the risk where you have a problem on the international market.

Mr. HALL. Yes, laying it off. Thank you, Mr. Chairman.

Mr. FLORIO. The time of the gentleman has expired. The other gentleman from Texas, Mr. Fields.

Mr. FIELDS. Thank you, Mr. Chairman.

I am sure that Mr. Olson has already been aptly welcomed by Mr. Hall. But Mr. Olson is a friend of both of ours, and universally respected, and we are glad to have him here today.

Mr. HALL. Would the gentleman yield?

Mr. FIELDS. I would be glad to.

Mr. HALL. Is it not a fact in Houston, as it is in Waco, as it is in Rockwall; that if he does not pay his premiums they are going to cancel his insurance?

Thank you, Mr. Chairman

Mr. FIELDS. Mr. Olson, I wanted to ask you, on page 9 of your testimony you talk about victims of negligence, suffering, tragic experiences deserving economic recompense. And you say litigation must be relied on to resolve the difference between the parties.

But then in the last two sentences of that paragraph you say, but the system must not lose its sense of reasonableness, and litigation must not be permitted to have an adverse impact on society.

And I was just going to ask you what you meant by that statement?

Mr. OLSON. Well, it is an observation, Mr. Fields, that I was alluding to on the notion of entitlement. I do not believe that any fair-minded, reasonable, decent human being would abdicate the tort concept of fault or the doctrine of negligence. But I think somewhere—and basically the reforms that the legislatures are looking to are joint and several liability, contingency fee, collateral source, punitive damages, venue, ad infinitum.

And basically, you will pardon a very personal reference. You and Mr. Hall know me well enough to know that I do not talk about this very much, not as a matter that it bothers me. I just never—do not wear it on my sleeve. But today, I do believe that when people are wronged, their reaction is sue. And there are times where I think that is a very proper reaction.

But I, for one, believe that our system of making one whole is not always—and I will use this personal example. I have two artificial legs. I was born club-footed, cast put on too tight, gangrene set in, and my legs were amputated. Well, my father is a lawyer. He sues doctors. He represents doctors.

And when I was in law school in tort I asked Dad, I said, I want to ask you a question, tell me why you and mother did not sue. And he said, well, first of all, it was a human being. But second, he said, we wanted you to be a healthy, loving, creative human being and not find fault every time something went wrong in your life.

All right. That attitude today in our culture, I would respectfully submit, where is the compensation for those kinds of decisions. That is not to abdicate the tort concept of fault. That is not to say you are not entitled for your—to be held accountable for your negligent acts.

We are seeing cases throughout this country where the jury verdicts given singularly, and not in the aggregate, if you knew the individual facts you may say, OK. But in the aggregate I think we have lost a sense of reasonable compensation. And the notion of sue versus the other notion of just let it slide, somewhere there is a middle ground.

And so when I said reasonableness, I am not willing to just take—for instance, I am opposed to the abolition of contingency fees. The insurance industry is advocating that. I do not think there is anything proper about that. You may want to structure them after the first 10 or 15 million.

And today, million dollar judgments are nothing that we—I mean, we read about them every day. Now in Texas you have got a \$10 billion judgment against Texaco. I don't know anything about the facts.

All I am saying is is that, as social architects such as yourselves, through tort the mores and the folkways of the culture emerge. And whether it is singularly left to the States to manifest the tort system, or whether it is left to the Congress through a uniform tort system, are the kinds of judgments that I think you have to make.

And I made that observation to point out that something is a little bit unreasonable in our culture, and the marketplace is telling us that through the reinsurance market. The international world looks at us and says, you know, we have enjoyed as much as we can stand price-wise, but your conduct is mitigating on our considerations now.

Mr. FIELDS. It is my understanding, that the state of Texas will be addressing some of the things you mentioned a while ago, in its next State legislature. Should any of those things be addressed on the Federal level?

Mr. OLSON. I certainly do think that they had better be talked about at the Federal level, primarily because I think you have got a system—you have two opinions. You have got those who want a federal tort system and those who do not.

And I think it is proper—you know, I have got an opinion on that, but I am a regulator, and I have got all the problems I can deal with with plaintiff's lawyers and defense attorneys in the insurance industry without getting in that fight, Mr. Fields. And I will very privately discuss it with you afterward.

Mr. FIELDS. I thank the chair.

Mr. FLORIO. The gentleman from Kansas.

Mr. SLATTERY. Thank you very much, Mr. Chairman. First of all, let me say that I really do appreciate your efforts in this area, Mr. Chairman, and I regret that my duties on the Budget Committee

have prevented me from more fully participating in these hearings. But I do plan to be over here on a regular basis as soon as my duties over there are completed.

I would observe that if there are any more $10 billion judgments in Texas, my good friend Mr. Hall here may have to reconsider whether he can better serve the citizens of Rockwall back in h'- law office than here in Washington.

Mr. Olson, I wanted to follow up on some of the information you provided in your testimony. And based on the, surely, objective recommendations that the committee has heard from both sides of the political aisle here today, you are the expert witness who can perhaps shed some light on this.

But I am just curious. In your testimony on page 3 you indicated that the losses from the writing of insurance policies in the industry apparently rocketed to a record $23.3 billion last year. I assume that is all insurance; is that correct? We are not just talking about liability insurance when you are talking about those losses.

And you went on to say, even with investment income, pre-tax operating income was a negative $3.8 billion. And that income after tax was less than $1.5 billion. Are you talking about all insurance?

Mr. OLSON. No, sir.

Mr. SLATTERY. Health insurance, life insurance, liability insurance?

Mr. OLSON. No, sir. Property casualty insurance.

Mr. SLATTERY. You are just talking about property casualty insurance?

Mr. OLSON. Yes, sir. And liability is included in casualty.

Mr. SLATTERY. Sure, OK. And then you went on to observe some of the more general reasons for the problems that we are having. And you seem to place considerable emphasis on the fact that the insurance industry as a whole engaged in a period of rather sharp competition that was followed by a period of dropping interest rates and dropping profits from investments of the insurance companies.

And now we are in a situation where they are experiencing huge losses due to these dropping profits on the investment side of their operation. And they are in the process, apparently, of recapturing these losses by dramatically increasing their premiums. Is that sort of a fair characterization of what you see going on?

Mr. OLSON. Yes, sir. And I was a little bit more—I really was not pejorative, but I was a little bit more direct before you slipped in, in that I think that the underwriters, that the insurance executives, and that the companies themselves were irresponsible. I think they were undisciplined. And I very firmly believe that, and I think that they would properly admit that.

Mr. SLATTERY. In Texas, Mr. Olson, maybe you have some information down there that would be of assistance to us in trying to quantify to what extent this problem is caused by overgenerous jury verdicts or verdicts by judges, and what part of the problem is caused by, shall we say, unprofitable investment by the insurance industry?

Maybe you have information that gives some light in terms of how the nationwide industry is affected. I am just curious if you

could say what kind of judgments were paid to plaintiffs all over the country, or in Texas, if you have that information? I am just curious.

Mr. OLSON. Well, everyone can probably address this. I will try to briefly say that, I am not personally you can quantify—the judgments are very clearly in our loss and loss adjustment expenses, and in the annual statements relative to claims paid out.

Mr. SLATTERY. Right.

Mr. OLSON. Loss adjustment expenses being attorney's fees. It is not at all unreasonable—and someone correct me on the panel—if in a casualty claim, liability claim, anywhere from 50 to 60 cents on the dollar goes to defense costs, both on the plaintiff's side and the defense side.

Mr. SLATTERY. So you mean attorney's fees, not defense costs.

Mr. OLSON. Yes, sir. Defense costs—legal costs.

Mr. SLATTERY. Legal costs.

Mr. OLSON. Both to the plaintiff and to the defendant's attorneys.

Mr. SLATTERY. Now is that a nationwide statistic, 50 to 60 cents on every dollar paid out by an insurance company is paid out for legal expenses incurred either on the part of the defendant, the insurance company, or on the part of the plaintiff?

Mr. MUHL. I think that is nationally.

Mr. OLSON. I think that is a fair statement to say. That if you look at all the annual statements relative to the liability costs, you would find that percentage in the aggregate.

Mr. FLORIO. Will the gentleman yield for a minute? I ask unanimous consent that the gentleman have an additional minute.

Mr. SLATTERY. Sure.

Mr. FLORIO. Will the gentleman yield?

It is my recollection from the days when I practiced law that plaintiff's attorneys usually have one-third—if you are talking about 50 percent, you have got to have on the defense side a substantial amount more than 50 percent. Since the defense attorneys do not operate on a contingency basis, that means there is less than thorough cost containment on the defense attorney's side in having bills run up?

Mr. OLSON. Mr. Muhl just pointed out to me that the Insurance Service Office suggested—what?

Mr. MUHL. It is about 23 cents on the dollar, the premium dollar is spent for defense costs. And that is on the rise. And that is where your initial concern is.

Mr. OLSON. So that would be——

Mr. SLATTERY. Let me ask my question another way.

Mr. OLSON. I am responding to the chairman.

Mr. SLATTERY. OK, go ahead.

Mr. OLSON. I was just simply going to say, if we are assuming the 30 percent plaintiff contingency fee, and if we are assuming the 23 percent, which I think all of us will say that is at least the fair number, if not low, then we are looking in that instance at 53 cents.

Mr. FLORIO. That is the premium dollar, not the payout dollar?

Mr. OLSON. Yes, sir.

Mr. FLORIO. Not the claims.

Mr. OLSON. That is correct, sir.

Mr. SLATTERY. Let me ask this question. Last year, do we have any information to indicate nationwide how much money was collected by property casualty insurance companies in premiums? What is that figure, does anybody know?

Mr. OLSON. I do not have it with me.

Mr. SLATTERY. If you assumed that the insurance companies last year did not lose any money on the investment side, had they just been able to put their money in the bank and not lose anything—as you have indicated that they actually lost money—but had they not lost any money last year, would they have been able to make a profit as an aggregate figure?

Mr. OLSON. Well, I think——

Mr. SLATTERY. I do not want to just limit to Mr. Olson, but what is the answer to my question?

Mr. OLSON. I do not mind sharing at all. In looking at rating, when you set a rate, you go back and look at Texas anyway. Bill, I do not know what you do in Florida. But we use anywhere from a 3-year to a 10-year timeframe, because you have to do that to get a real picture.

For instance, we do not really know what the losses were in 1985 and 1984. What we do know is that in 1982 there were seven insolvencies in Texas, 1983 there were 12, 1984 there were 18, and 1985 there were between 77 and 81. So we know that companies failed. From their annual statements which we received in March, we know that they took substantial losses.

This is going to sound a little strange, but our indications are, in Texas—and we are using negative profit loadings of which I have some problems with—but, we are showing that investments by many insurers or investment income is not using a linear progression instead of a exponential curve which we use in ratemaking—using a linear progression, we are showing that investments correspondingly are up, but they are not up to the extent that it has offset those losses.

So, it is not the bad investments. It is primarily the function of the interest rate, that the time value of the money that they received in that embedded yield of the 15- to 20-percent interest rates.

Mr. WASHBURN. The estimate is $142 billion in premiums, $142.3 billion in 1985.

Mr. SLATTERY. What were the losses paid?

Mr. WASHBURN. Their estimated losses were 89 percent. That would include the incurred but not reported—was 89 percent of that. The underwriting expense, acquisition costs and all that were estimated at 26.25.

The dividends—and these are dividends to policyholders. Basically it is a premium payback for workers comp. If you have better experience, you get some premium back—added another 2 percent to that.

So the total loss experienced was—total property and casualty was 117 percent. That is what they estimate. $25.2 billion.

Mr. SLATTERY. Say that again.

Mr. MUHL. So for every 117 percent, which means for every dollar they received in premium they spent $1.17.

Mr. WASHBURN. Right. So their total losses were $25.2 billion.

Mr. GUNTER. So obviously investment income takes a——

Mr. SLATTERY. I am trying to understand the basic math.

Mr. WASHBURN. That does not reflect investment income.

Mr. SLATTERY. So the premiums were $142 billion.

Mr. WASHBURN. Right.

Mr. SLATTERY. You are telling me that the loss payment was $89 billion?

Mr. WASHBURN. No, no, 89 percent. I am sorry, they have got it in percentages. They do not have the numbers here.

Mr. SLATTERY. 89 percent. And then underwriting expenses were 26 percent?

Mr. WASHBURN. Right, and 2 percent for premiums to policyholders. They include that in their column of costs, because dividends to policyholders are basically paybacks for good experience on workers comp rates. It is like a premium return.

Mr. GUNTER. But clearly, Mr. Slattery, the total profit picture, I think, needs to be taken into account. Insurers would prefer otherwise. Insurers would prefer that the view of regulators be focused only on underwriting results. I do not think there is a single regulator here though that does not believe that you need to take into account investment returns.

Mr. SLATTERY. Could I ask one last quick question?

Mr. WASHBURN. Their investment returns, by the way, they estimate are $19.7 billion.

Mr. SLATTERY. What has been the historical, in the last 5 years or 10 years or whatever you have, track record in terms of return on investment for insurance companies?

Mr. OLSON. One of the problems you get into in ratemaking is, we may use a total rate of return on net worth, rate of return on equity——

Mr. SLATTERY. Why do you not use a rate of return on premium dollar? You cannot do that?

Mr. OLSON. No, sir. Legally, you have got to be more exact than that for constitutional confiscatory problems. If you were big enough you could. But properly, using a rate of return on net worth, which the National Association of Insurance Commissioners, I might add, adopted that about—what, Bill, in 1983?

Mr. GUNTER. Yes.

Mr. OLSON. In 1983 under Bill's administration, and it is very difficult to predict. I would need the spread sheets in front of me to give it to you.

Mr. FLORIO. Perhaps if you are not able to provide it now, for the record, the gentleman's questions, the statistical questions particularly, I am sure you might be in a position to provide to us. We would appreciate it.

Mr. MUHL. We would be more than pleased to supply that.

Mr. LENT. Could I just get one —

Mr. FLORIO. The gentleman's time is extended for an extra minute.

Mr. LENT. Will the gentleman yield?

Mr. SLATTERY. Yes.

Mr. LENT. Thank you. On that point, we have heard testimony that in 1984 the insurance industry lost money on the premium side. The insurance industry made money on the investment side.

The net combination of the two in 1984 was that the insurance industry lost $3.8 billion.

Mr. WASHBURN. They had capital gains.

Mr. LENT. Well, forget the capital gains. You are selling off your assets in order to obtain capital gains.

Mr. WASHBURN. That is right, you are selling off your assets.

Mr. LENT. My point is that combining investment income and premium loss there was a net loss in 1984.

Mr. WASHBURN. It started in 1984. It was larger in 1985. 1984 was the first year that they did not make as much money on investment income as they lost on underwriting.

Mr. LENT. Right. And the final figures for 1985 are not finalized yet. But, you are telling me they anticipate there will be another year of loss in the insurance industry.

Mr. WASHBURN. That is right.

Mr. FLORIO. Would the gentleman yield?

Mr. LENT. Sure, I'll be happy to yield.

Mr. FLORIO. First of all, is it appropriate not to count capital gains? But more importantly, how do we understand then the fact that in the market today insurance stocks are very, very highly priced for an industry that you have just described as being a basket case?

Mr. GUNTER. I think one of the reasons for that is the fact that the investors are certainly very much aware of the rate increase picture that is occurring across the board. As a result of that expect a very different picture in the ensuing year. And as a result, you see the institutional investors, far and away above the norm, above the scale investing in property and casualty insurance stocks. I think they are looking forward to profits and returns on those investments.

Mr. WASHBURN. For years the industry maintained that their stocks were undervalued, but no one wanted to buy them because the price seemed to be going down. So in that sense, they think they may be coming up.

No. 2, you have to remember, that is all of property and casualty, the majority of which is property. A lot of it personal lines where the loss is not near as great. Casualty insurance, the loss ratios have been much worse than 117 percent in just about all the lines. And that is where we are having our problems today.

Mr. GUNTER. But I do think it is proper to consider capital gains. Not unrealized capital gains, but capital gains in the total financial picture of an insurance company.

Mr. FLORIO. The time of the gentleman has expired. Let me just develop a point.

Mr. Olson, I was very impressed with your waxing philosophic. And I think in many respects you raised very legitimate questions.

Let me attack the same problem from a different perspective. There is a—the concept of risk abatement is one that I suppose the judicial system does contribute to in a somewhat sloppy way, but by virtue of judgments, the result is, we think, that there will be an effort to abate risks so as to avoid liability.

That is clearly not preferable. And some of us have developed some thoughts in terms of the regulatory system in the areas of health, in the area of environment, breaking down to a certain

extent, such that people feel they have no alternative in the face of injury but to resort to the courts in ways that in the past they may not have felt the need to do.

We had a hearing here yesterday where EPA testified. The Congress passed a clear, unequivocal piece of legislation saying, no more dumping of toxic wastes that are untreated into land-based disposal systems. That was fairly clear. The Administration, the EPA, came out with a set of regulations that said, yes, you are allowed to, under the rest of these circumstances.

In the face of that type of regulatory situation—first of all, we are not surprised that insurance companies say, we do not want to insure when there is no set of regulations. We are not surprised when people get injured as a result of drinking water out of a toxic waste dump site that is not supposed to be in operation, that they resort to tort.

We can go straight down the list. You mention trucks. Well, the regulatory agency in town here is not enforcing its own regulations with regard to front-end brakes. We have provisions on the books about under-ride protections that should be put into effect that have not been done.

You talked about Texaco. We could talk about the unavailability of corporate director insurance. Well, the antitrust laws are, in many respects, not being enforced in the traditional way, so it should not be a surprise that you have got disruption in the corporate marketplace such that there are more risks as a result of instability.

Is there any justification for resort to the tort law as a result of the failure, if you accept the premise, of the regulatory system in many areas to do what it should be doing to abate the risks?

That is to say, if the risks are not abated on the front end, you are going to have to pay the price at the back end when someone is injured and there is no other game in town. If the Congress is doing only so much, the executive is not doing very much, the judiciary has got to pick up the slack.

Mr. OLSON. Well, you know, I have not examined the premise, so I will take it on the assumption that, first of all, the premise is based on that we are always going to look to something to abate the risks. Either the body politic, to wit, government, or to our system of civil justice.

Mr. FLORIO. Mr. Olson, let me just raise the point right there because I think—I do not think there should be any dispute that you are not going to have social stability if you have a situation where people are wronged without remedy anywhere.

Mr. OLSON. I agree.

Mr. FLORIO. At some point, when enough people feel there is injustice in the system, you do not have a system.

Mr. OLSON. You have got it, 100 percent. And I agree with that, and I agree with that premise.

The part of—well, I really do not—I do not know what I disagree with, because frankly, I just have not thought it through.

But there is an article—and please forgive me for—I not trying to sell anybody's magazines—but there was an article in Forbes magazine in July, I believe, of last year entitled, A World Without Insurance. It was very interesting.

You know, if you want to really see what in reality are your risks, look at the insurance mechanism. Take, for instance, an issue that you have been extremely involved in, the Superfund. Take a nuclear waste—take nuclear activity. What do the international reinsurers tell you?

On the one hand, we want that source of energy. At least, as a populace, I think we have manifested that interest. But the insurers on Three Mile Island that came to New York a couple of years ago, could not even get homeowner's insurance next to Three Mile Island. Why? No insurer wanted to write that risk.

There are some risks—our technology, if you talk to the reinsurers today, our technology is so immense that we do not know where we are going.

First instance, go to a college town, or I guess you can go right here in Washington, DC, one of these suntan parlors. Now I am not against—I think everybody should have a nice tan if they want one. But we do not know what our technology is doing to us today. We do not know what the CRT's relative to radiation are doing to us visually. We do not know what these suntan parlors are going to do to the epidermis 20 to 30 years from now.

And our technology is so vast, and we are asking someone to pay a price today for something that may manifest itself 20 years out. And that again exacerbates the risk abatement.

Mr. FLORIO. Mr. Olson, let me just—I do not think everybody is going to make the argument that the suntan industry is performing a sufficient, vital public purpose, that is not something that should not be facted into the cost of suntans.

Now you talked about nuclear facilities. We talk about environmental cleanup to ensure a continuation of the chemical industry; very important public purposes. Do we not have to follow your train of logic to its ultimate conclusion? That if there is such a public cost to be burdened or be carried because of these very important public functions, do you not almost put into question the viability of the private insurance industry to shoulder the public costs of those public-oriented endeavors?

Mr. OLSON. I think, if you do not agree with that I think you at least have to ask the question—and I will shift from property and casualty to hospitalization. I oppose a Federal Health Insurance Program. But I stop short of dealing with a catastrophic illness.

Mr. WASHBURN. I think you addressed that with swine flu.

Mr. FLORIO. Disastrously.

Mr. WASHBURN. There was a public purpose that the private sector said, how are we—we have no way to know what our exposure is on this. We are not going to be able to rate it. And if I am not mistaken, you assumed the burden.

Mr. LENT. And lost money.

Mr. MUHL. But assumed the burden and established certain immunities in that process.

Mr. OLSON. DPT today, is a good one, relative to product liability. Because of product exposures, there are two major pharmaceuticals that have pulled out of DPT. I mean, you have just shaken the ground in Houston, TX and New Jersey and everything else when a mother's child cannot get the DPT, be they rich or poor.

And I think probably you all are—I do not know if you have been asked yet, but I suspect you will—if that DPT vaccine, if the Centers for Disease Control cannot—they say they are 50 percent short today—or at least they said that about two-and-a-half months ago—where is that going to come from. You are going to have to get back into that.

Mr. SLATTERY. Mr. Chairman.

Mr. FLORIO. My time has expired. I will recognize the gentleman from New York and he may yield.

Mr. SLATTERY. I appreciate it.

Mr. FLORIO. Unanimous consent to extend my time for an additional minute? Happy to yield.

Mr. SLATTERY. OK. The counselor from Rockwall and I were trying to answer a very basic question that is concerning to me. And that is, can you explain to me why insurance companies—to use your example of insuring the suntan parlor—why they cannot agree that they will insure the operation of that for liability purposes to the tune of a $500,000, or $1 million or whatever? And thereby, they have quantified at least part of their risk and agreed to a premium to justify that.

Explain to me why that is.

Mr. WASHBURN. They thought they did that with both the asbestos and pollution, with something in the pollution law that said, sudden and accidental exposure. And there has now been a court case in New Jersey that sudden and accidental could mean seepage.

Mr. FLORIO. If the gentleman would yield. But the difference, of course, is—what the gentlewoman from Kansas is talking about is absolute, written-in liability limits. The ambiguity in the policy you are making reference to was interpreted by the court against the insurance company, which is a traditional approach.

Mr. WASHBURN. Their problem is, they are not sure they can write it. I mean, they thought they had an absolute limit on their exposure for asbestos, as an example. And the court, through the ruling on the triple trigger, allowed the policyholder to allocate people so you do not run out of limits.

Mr. SLATTERY. I hope that our—well, let me ask this question. Has our contract law in our country deteriorated to the point where an insurance company cannot say that we are going to insure, you know, XYZ trucking company in Holton, KS, to the tune of $1 million?

In other words, if they are moving flammable liquid down the highway, and the driver runs a stop sign and blows himself into yesterday, and, some other people as well, then the contractual liability of the insurance carrier will be $1 million, period.

Now tell me why—what has happened to the contract law of this country that prevents the insurance companies from being able to say: our liability coverage is $1 million, your premium is x amount. What prevents them from quantifying the risk in that fashion?

Mr. WASHBURN. In terms of peril, they think they probably have the ability to quantify the risk. There does not seem to be a great deal of problem in terms of earthquake—well, earthquake I should not say—but fire, or hail, or some of those things.

But in terms of long term exposure, or ways that in some cases the court will say, your policy really meant this when they had not intended that to be the case, and they will reinterpret it 20 years back. The claims-made is the insurance industry's attempt to quantify their risk. They have an absolute cap and it is only on the claim.

The problem is, that even the industry is split on whether this will solve the problem. Some in the industry feel that the claims-made will be interpreted as such as in the current policy. And they did not want to go with the form.

Mr. SLATTERY. Do you have any problems with being able to limit your exposure under automobile insurance coverage, for example? Is there some doctrine—this is going back 15 years.

Mr. HALL. Will the gentleman yield?

Mr. SLATTERY. I would be happy to yield to the counselor from Rockwall.

Mr. HALL. I think being probably the best lawyer on the subcommittee——

Mr. SLATTERY. You are claiming that distinction, Mr. Hall.

Mr. HALL [continuing]. Maybe in the room.

Let me tell you how these things work. By the way, I was speaking to 90 physicians in Smith County, staid, conservative, Republican Smith County and asked for a show of hands on how many had been sued. Over two-thirds of them held up their hands. That amazed me. That does not amaze you men because you have been taking those statistics for a long time.

But, they have a loss and they have a policy covering it that the insurance company presumes is the maximum amount they have to lay out. It could be a frivolous lawsuit, or it could be a suit filed to settle, it could be a suit filed because the adjuster did not answer a call.

But then the doctor feels, that although he has insurance, and the insurance company owes him a defense; he does not totally trust that insurance company and he gets his own lawyer. In Texas—I do not know about other States—his own lawyer writes that insurance company and says, I have coverage for a million bucks, but if you do not settle it within the million-dollar coverage, you are liable for all the rest of it.

What is that called? Staries, or what is the decision? I cannot think of what it is.

Mr. SLATTERY. You are obviously the more knowledgeable lawyer in the room.

Mr. HALL. If they do not pay it within the policy, they are liable for all they sue for under the circumstances, when they are put on notice. That is the case that they did not honor their contract.

Now that is what runs the insurance companies and the people that try to write these risks and figure up what they are going to lose, that is what runs them out of their tree.

Mr. OLSON. One of the other things I think I said before you came in is that, there are just some fundamentals you have got to always keep in the back of your mind.

Mr. HALL. And that is the court. The courts get last guess at what the law is.

Mr. OLSON. That is right. The insurers—you are saying—I mean, I think what I hear you asking is, why is there not some limit or some reasonableness out here about what they are going to cover.

Mr. SLATTERY. No, there are two different questions. I mean, there is a question with respect to limits imposed on jury verdicts, for example. I mean, that is one option.

The other option is—and this is what I do not understand—is why insurance companies cannot quantify their risk by limiting their liability insurance coverage. So that if you are insuring company—I have trucking companies, small manufacturers in my district that have had their insurance premiums, 200, 300, 400 percent, what have you in the last few years. And I have had situations where they have just said, we are not interested in insuring you, period. And many of these companies have never had a claim.

And I do not understand why those insurance carriers cannot come out to XYZ manufacturer or XYZ trucking company and say, we are going to insure you to the tune of $1 million for whatever risk, you know, and it is for 1 year, or whatever, and contractually limit their liability with the parties involved.

Mr. OLSON. Well, if you are a willing purchaser and the insurer is a willing seller, you want the best deal you can get in town, for the most coverage to protect you from the greatest amount of exposure.

Mr. SLATTERY. Right.

Mr. OLSON. I started off by saying, their greed will always overcome their fear. And they are going to give you a deal if they can afford it.

Now the reason that in the aggregate they do not look at you individually—they may if you are big enough. I mean, you have folks in this room—if you are big enough, if you have got the premium volume, the laws of large numbers, the universe that is expansive ad infinitum, they are going to look at you.

But when they reinsure that block of business, primarily that liability, that casualty coverage, be it by facultative or treaty reinsurance, they are not going to look at your risk singularly. They are going to look at their perils to which they are—or from which they are exposed in the aggregate, to lay off their exposure.

And that is what makes so many people angry. I mean, it is just tough to explain to a day care center owner or to a trucker——

Mr. SLATTERY. Well, you are really not answering my question. My question is, I am still unclear as to why the insurance company, in the aggregate, dealing with hundreds of businesses or one business, cannot just say, I will insure you to the tune of $500,000, or $100,000, or $200,000, what have you, and say that is my limit. I will not insure you for risk beyond that.

Mr. OLSON. They can. They can do that.

Mr. SLATTERY. And if they do that, why can they not provide insurance to these people? These people do not need $50 million worth of insurance.

Mr. OLSON. Today, they cannot get reinsurance.

Mr. HALL. But Mr. Commissioner, if they write that contract that the gentleman from Kansas is asking about for say, $300,000 per injury, and I have lost a leg. That my insurance company thinks that leg is worth about $100,000. They want to settle it for

that; but they get this letter written to them that says, I have lost a leg and I am entitled to at least $300,000, and you protect me by laying down your policy limits, or you have not honored your contract.

Then there is no way that you can write it, unless you are going to reinsure or lay off or whatever you do beyond the $300,000. There is no way that you can protect yourself against that, that I know of.

Mr. SLATTERY. Can I follow up just a second? We are raising a different issue here a little bit, because my memory is coming back from law school 15 years ago.

Mr. HALL. You raised two issues and I have only answered one of them.

Mr. SLATTERY. The question is, and the point you are raising goes to the question of the conduct of the insurance company, and its inability or refusal to respond to a legitimate claim.

Mr. HALL. And justifiably so sometimes.

Mr. SLATTERY. And justifiably so sometimes.

Now any award that is given to a plaintiff in that instance is given to remunerate them under some sort of a breach of contract on the part of the insurance company; is that not correct? In other words, they did not come forward and pay their claim as they should have.

Mr. HALL. If they did not give them a defense and did not settle their claim within the policy limits, and they are put on notice of that.

Mr. SLATTERY. But is there not a question of reasonableness also involved?

Mr. HALL. Yes.

Mr. SLATTERY. In other words, the insurance company——

Mr. HALL. But they sue the insurance company, and the insurance companies are target defendants in my State.

Mr. SLATTERY. I would be curious to see some cases on that.

Mr. HALL. There are a lot of them.

Mr. SLATTERY. Because if I remember correctly——

Mr. FLORIO. Will the gentleman yield?

Mr. SLATTERY. Yes.

Mr. FLORIO. Is this a particular idiosyncrasy of Texas law that is being talked about?

Mr. HALL. No.

Mr. SLATTERY. No, it is not.

Mr. MUHL. That is widespread.

Mr. HALL. What is the name of the decision—one of you lesser lawyers can tell me, maybe.

Mr. FLORIO. You can submit it for the record.

Mr. WASHBURN. But you have got to remember, the other side of that question is, you have got to also figure, out of that pool of policyholders out there, how many are going to go to that limit?

Mr. SLATTERY. Well, that is the ABC's of underwriting insurance.

Mr. WASHBURN. That is right. And as an example, for day care, even though they limit it, they may not feel they have enough knowledge about how many of those policyholders are going to go to the limit, because they feel the world—they cannot look back-

ward—that the world is changing on them. That the nature of that risk has changed, and they are unable to quantify the change.

With truckers, two of the major carriers that handled truckers have fallen on hard times; have had to cease business.

Mr. MUHL. Insolvent.

Mr. WASHBURN. They have become insolvent.

Mr. SLATTERY. Is that a function of their investment problems?

Mr. WASHBURN. No, that is a function of the price was too low.

Mr. SLATTERY. The what?

Mr. WASHBURN. The price was just too low.

Mr. SLATTERY. Now wait a minute. You know, we have already heard from Mr. Olson that premiums were dramatically reduced in a fit of competition. And you know, premiums may have been too low at some time, perhaps.

But the problem may stem from the fact that the money that they did have to invest and handle was improperly handled, or they did not plan ahead.

Mr. WASHBURN. They did not keep up with their expenses. I mean, it could be a series of things, but basically—I mean, the two major writers of truckers went out of business, and the majority consensus in the industry was that truckers were underpriced.

And the other problem is, that many of the companies that are in the casualty business do not feel their underwriters are able to look at a trucking risk and be able to make an evaluation. You determine expertise in the business the same way you do everything else.

Mr. FLORIO. Will the gentleman yield on that point?

Mr. SLATTERY. Be happy to.

Mr. FLORIO. I was at a meeting not too long ago, and there were apparently not too many insurance companies writing insurance for toxic waste dump sites. There is one particular company that is still in there.

And it was suggested to me by people that appeared to be knowledgeable that that company had expert underwriters who were in the position to know what they were doing saying, we will be happy to write. You ' 'e to have double liners, you have to have this.

So does that not spell out maybe some deficiencies on the part of the industry in terms of having expert people who can do what the insurance industry is supposed to be doing, which is defining risk, costing it out, and that might be part of the problem as well, is it not?

Mr. WASHBURN. I think that many knowledgeable observers in the industry maintained that the underwriting functions in the industry atrophied. And they do not have the sharpest people in the world doing some of the underwriting.

And that is one of the reasons that we have had the type of wholesale midterm cancellations and so forth, because they do not have the faith in their underwriting functions in terms of being able to pick good and bad risk.

Mr. MUHL. And that is why a lot of these companies jumped into specialty writing. For an example, the day care folks, the bulk of that business written by Mission. Transit Casualty writing the bulk of the barowners, restaurant owners, and transportation facility.

So where they had expertise, that is where they would really go after that market and try to capture as much of that market as possible.

Mr. FLORIO. Is that any different from most of the rest of business? I mean, lawyers are going into boutique law firms because of the complexity that we are talking about in our whole economy. There is a need for a higher degree of specialization.

But I wonder if that also does not put into question the basic premise that our whole economy works from, which is, there will always be someone there to provide protection from market abuse by virtue of competition.

If we have such highly specialized businesses in all of our economy—this time we are talking about insurance—can we expect that there will be knowledgeable competition, as opposed to competition that comes in without specific knowledge just for the quick buck, and hence we have the problem.

Mr. OLSON. In fact, you put your finger right on it in that, in this conversation we are assuming that underwriting means something. And what you have put your finger on is, is that in the last 6 to 8 years, the insurance industry, if you look at their organizational chart, probably their marketing vice president was in charge of the company, not the underwriter. Because the object of the game was, money in, time value of money, claims paid out.

Then when the worm turned, now every risk is probably being looked at with a magnifying glass and a blowtorch.

Mr. FLORIO. That is the same observation some have made with regard to things like the automobile industry where the marketing people were greater in prominence than the quality control people might have been. Hence, we now have Japanese automobiles. I suspect we may be seeing Japanese insurance before too long if the same quality deficiencies happen to be there.

The time of the gentleman has expired. Recognize the gentleman from Texas.

Mr. FIELDS. Mr. Chairman, I just want to go back to the point Mr. Slattery was making. And it is my understanding that in some court decisions there have been stacking of policies. That if someone were given a million dollar coverage in, say, 1983, and the same coverage in 1984 and 1985, and then there was some lawsuit, instead of it being a million dollar coverage for 1986, when the lawsuit was settled it was $3 million for 1983, 1984, 1985 stacked together. And if I understand it correctly, that came from a decision called the *Cain* decision. And it might be something that this panel would want to respond to now or respond to us later in writing.

But I think it is part of the direct answer you were raising as to, what the problem is in the insurance industry.

Mr. MUHL. Just to elaborate on that. Any insurance company will write the business, whether it is day care, or get involved in any lines if they can reasonably predict what that loss is going to be, put a price to it, and then sell that product and attempt to make some money.

But when you—and I think Lyndon Olson referred to it earlier—when you have, on this prospective guess into the future by the insurance company, this is not something if they guess right, that is great; if they guess wrong, that is OK, too. But they cannot make

up for past losses. They are projecting into the future what their loss is going to be.

When you have a rule, a change in midstream, once they have gone through all those processes of predicting the future, setting the price, evaluating, measuring the risk, and when you change something in midstream, they cannot go back and get the premium, but they are on the hook for a lot of the risks, such as the stacking of the coverages.

And that puts a real strain on the system and causes all these underwriters to sit back and second-guess why they are there to begin with, and whether or not they want to take that risk and that chance.

Mr. SLATTERY. Will the gentleman from Texas yield about 30 seconds?

Mr. FIELDS. I would be glad to yield.

Mr. SLATTERY. This raises, you know, a real touchy point, because historically the insurance industry in this country has resisted Federal regulation, Federal involvement, and I generally support that approach.

Mr. MUHL. They resist State involvement as well.

Mr. SLATTERY. That is very true. But I think that people like Mr. Olson all across this country are needed, certainly. I do not think there is anyone here at the panel that would deny that.

But the concern that I have is is that the point that the gentleman from Texas made raises questions perhaps about a faulty contract that a particular company had drafted and offered in the marketplace. And that is something that we cannot overlook either.

Mr. MUHL. Absolutely.

Mr. SLATTERY. There is a problem here sometimes with ambiguous contracts. Maybe the contract was drafted in such a way as to lead a normal lay person to conclude that, in fact, the premium on an annual basis was to purchase 1 million dollars' worth of insurance, ad infinitum, or what have you.

Mr. MUHL. I could not agree with you more.

Mr. SLATTERY. And I do not know that there is anything the Federal Government can do to deal with that problem.

Mr. OLSON. Let me tell you what one State does. Texas—I do not think there are any other States in the Nation that do it. We only have one contract that is approved in Texas.

Mr. FIELDS. Mr. Chairman, I would like to just reclaim my time, and congratulate you for having this hearing. I think it is excellent that we discuss this. I think we need a better understanding of what is happening out in America, and people who have expertise, who deal with this on a daily basis. And I just want to publicly commend you for having the hearing.

Mr. FLORIO. Thank you very much.

We have one more witness, and I would like to just ask two questions for brief answers. One is on reinsurance.

Something I seem to be gleaning from this discussion this morning is that in many respects, reinsurance, and the absence thereof, or the unavailability thereof, is almost a precipitating event or the precipitating domino that works back down to cause this problem.

And then the other impression I have—not only because of so much of it being overseas—but also because it is not conducted as a normal business would appear to be conducted. We are talking about—laying off brings visions of bookies. But it is not too terribly much different than that. A couple of people in a syndicate in a somewhat unaccountable form operating.

Which leads me to a question with regard to your capability of regulating the reinsurance business, which is, in a sense, the heart of the insurance business. Particularly if there is any legitimacy to the major emphasis being put on tort judgments that are beyond what people would expect in their primary insurance coverage.

And if—there is a question as to whether you have the capability of insurance—regulating primary insurance people. Do you have the capability, or even the desire to regulate reinsurance people.

Which leads me to a last point, as to how the antitrust laws operate, how McCarran-Ferguson operates with regard to reinsurance. I know there is a form that Lloyd's is putting out there. And they are doing it with insurance companies, they are doing it with insurance regulatory agencies. I think everyone has assumed that is something that the antitrust laws do not impact upon because of the protection.

But the McCarran-Ferguson Act provides that protection if the States are involved in regulating the business of insurance. If you are not involved in regulating the business of reinsurance, how is it that we have this sort of collusive arrangement whereby somebody is dictating what the form is among competitors?

Mr. OLSON. Very simply, reinsurance—in my judgment, reinsurance is the driving force in this constriction of the marketplace, No. 1.

No. 2, I would submit to you that we—there are reinsurance companies in the United States that we directly regulate like we would regulate any other primary domestic insurance company.

I would submit that we, to the extent that we can regulate international reinsurer, we do it only for the purposes of security. That is to say, if an exposure occurs, an occurrence happens, you want that reinsurance contract to be available internationally. You cannot regulate it to the extent—and so we establish minimum guidelines for letters of credit.

A company such as the Aetna that would lay off to Lloyd's of London, to Switzerland, France and wherever, in order for them to get credit on their ledger sheet for the removal of a liability, for a premium they would pay, to that extent we can regulate letters of credit and what constitutes credit for their reinsurance.

But once we leave the territorial jurisdiction of the United States of America, the antitrust laws or any regulatory body has no jurisdiction.

We went through this in the Ados fraud, the Justice Department and Superintendent Lewis, then of New York, we had $400 million in exposure in the United States that actually ended up in Ados, in a Rumanian-owned company fronting Communist countries.

Mr. FLORIO. I am not sure I understand. If you are saying that a uniform form is being presented by a——

Mr. OLSON. There is not a uniform form.

Mr. FLORIO. The claims—the occurrence form, the claims-made form did not emanate from the reinsurance industry?

Mr. WASHBURN. Remember reinsurance is basically additional capital to a company that is selling business. It is much like a loan. And they come in and they say, if you want this loan, here are the terms and conditions we would like to maintain. And it comes from overseas.

It is additional capital that helps write more risks in the United States.

Mr. FLORIO. But what you are saying, I thought, today, if that is not available, the whole industry is almost not viable.

Mr. MUHL. The U.S. companies do not have the capacity to write all the insurance that is in demand.

Mr. FLORIO. There is therefore an unregulated entity or unregulated industry that is effectively able to make moot what you folks try to do at the State level.

Mr. WASHBURN. No. The additional capital from overseas allows more business to be written in America. There is so much capital allocated to insurance in the United States.

Mr. FLORIO. Or it does not allow more business.

Mr. WASHBURN. Or when it comes back, when it ceases—and some of the ceasing was because they took such major losses. The Japanese just decided that they did not want to be in here for a while, or several other companies decided they did not want to do it for casualty business. They still do it for property business.

They move their capital elsewhere. And that is entirely correct. If they do not think they can make money, they are not going to allocate capital here.

What that means is, there are less risks being written. U.S. premium dollars account for, I think, 51 percent of the world premium.

Mr. FLORIO. Did I understand you to say, or one of you to say that Lloyd's is not demanding that the claims-made form be adopted before they will have reinsurance?

Mr. WASHBURN. Lloyd's, for particular type of risks have said that they will not continue to write risks, probably next year, unless they are written on a claims-made form.

Mr. FLORIO. And you just told us, that unless that capital is available from overseas, the viability of the primary insurance field is gone.

Mr. WASHBURN. No, it is not gone. It is just restricted.

Mr. MUHL. It is diminished.

Mr. WASHBURN. There is less capital available for writing insurance.

Mr. MUHL. Correct.

Mr. FLORIO. And you are saying that insistence on the part of the overseas reinsurance company to provide or not provide capital for the viability of this industry is not violative of the antitrust laws, you do not think?

Mr. OLSON. You have got an international market that is the purest form of free enterprise. And it is there for one reason, to make a dollar. And if that—literally, if that Saudi company, or if that name in Lloyd's of London, or if that investor in France, or Brazil, or Japan says, we want to make some money, but we do not

want to do it in the United States, we are going to another country. I question how you reach that transaction——

Mr. FLORIO. I understand. I am not advocating this because I do not understand it conceptually. One of you said earlier on that, if the Federal Government ever became in the reinsurance industry as some have advocated before our committee, they would obviously be losing an awful lot of money.

How is it that that would be the case when you are saying that by definition, these other people are not in it for charity. They are in it to make money, and presumably they are making money when they decide to take part.

Mr. MUHL. That is the point.

Mr. WASHBURN. They lost——

Mr. FLORIO. There is nothing inherently a problem with the reinsurance business. Presumably, it has been profitable for people.

Mr. WASHBURN. No.

Mr. MUHL. The reinsurance facilities have sustained their greatest losses as the primary carriers in the United States have over the past year or two.

Mr. WASHBURN. The reason they are pulling out is they lost so much money. And one of the problems is, they are dependent on the carriers in the United States charging them an adequate rate, because they usually take a percentage of the rate. If the rate is inadequate over here, it compounds on them over there.

Mr. FLORIO. So you are saying there is enough blame to go around in terms of over-insurance as well as inappropriately priced premiums.

Mr. MUHL. Absolutely.

Mr. FLORIO. Let me just ask my last question. Have we got anything to be concerned about when your organization reports to us that there are 300 property and casualty insurance companies that are now on your early warning insolvency list? Inasmuch as there is no FDIC for insurance companies——

Mr. WASHBURN. But there are guarantee funds for the policyholders.

Mr. FLORIO. On a State-by-State basis.

Mr. MUHL. That is correct.

Mr. FLORIO. And my understanding is that not all of them are perhaps what they should be.

Mr. WASHBURN. Well, every State has a guarantee fund, which works off an assessment mechanism, in terms of property and casualty business, which is where the major problems today lie in terms of numbers of companies in trouble.

And we are seriously examining whether they have the capacity for multiple insolvencies. They have had, to date had enough capacity to take care of the problems that hit. If a major company went down, they have, I think it was a billion five worth of capacity nationwide.

Mr. FLORIO. Who does?

Mr. WASHBURN. Nationwide the guarantee funds do.

Mr. FLORIO. For example, you mentioned before about American Express having to put money into Fireman's Fund.

Mr. WASHBURN. Right.

Mr. FLORIO. Let us assume they did not have the money at that time. What would have been the outcome?

Mr. WASHBURN. Well, Fireman's Fund—I mean, I have no idea how drastic it was—but Fireman's Fund probably would have had to eat into its surplus. And if it did not have the surplus it would have been insolvent.

Mr. FLORIO. That is interesting. You also mentioned—and I found your initial comments very interesting—you also mentioned about reserves. And I saw this CIGNA article saying that even though the feeling in the industry is that there are inadequate reserves out there already—this new approach of not putting cash reserves in—but anticipating an inadequate amount of reserves out there already to be based upon anticipated earnings of the minimum amount of cash.

Does that cause you some concern?

Mr. WASHBURN. It certainly does.

Mr. FLORIO. But if we have got something to be concerned about, if you have got 300 companies that you have said are problem companies and the potential is potentially—the reserve system is already underfunded, and there is a new approach that is being advocated by some that may not be sufficient.

And then, there is a serious question with regard to solvency systems, maybe we should be even more concerned about that than we are about unaffordability or unavailability of insurance.

Mr. WASHBURN. Well, we are certainly looking at whether we have a structure that can adequately take care of the problems we see coming up. I mean, we started that last year. We are revising our laws right now. And we are still looking to try and determine we are trying to construct a scenario of what happens if an insurance company goes insolvent.

It is a little bit different than a bank in the fact that the payout is longer. No. 1, you have got assets there that can be tapped into. And No. 2, all the claims do not come in on the same day. Insurance is a little bit different in the fact that you do not have to pay off every claim on the first day you take over a company. They come in over a period of time.

Mr. FLORIO. Can you give us some indication of the magnitude of the problem that you foresee coming?

Mr. WASHBURN. Well, we have tried to look at what happens if a major company goes insolvent. And so far we think we can handle everything but, say, the top five, as an example, within a year or two.

Mr. HALL. That is in your State?

Mr. WASHBURN. Well, we are trying to do it on a State by State basis, but on a national—we started off on a national basis in terms of how—what sort of systems we have in place.

Mr. FLORIO. Is that in your capacity as the chairman of this committee that is for the entire organization?

Mr. WASHBURN. That is right.

But we are also studying some likely scenarios of what happens if certain companies go insolvent. And we are trying to build a structure that will tell us, if indeed we need, say a prefunded structure, or whether we need an additional ability to assess the industry on a postinsolvency basis.

Mr. FLORIO. How would you have a national prefunded structure on a State by State basis?

Mr. WASHBURN. Well, the basic way it would work would be, you would have an assessment. Right now, they assess on a State by State basis, depending on premium volume. They can assess up to 2 percent.

What you would do is build up a preassessment fund prior to insolvencies. That would basically be reflected in the price, but it would feed into a fund on either each State or some sort of national fund.

Mr. FLORIO. Not an FDIC concept?

Mr. WASHBURN. Somewhat an FDIC concept.

Mr. HALL. Mr. Chairman.

Mr. FLORIO. The gentleman from Texas.

Mr. HALL. I may be a little forgetful in some ways, but I remembered Jim Kroncher's telephone number. The line of cases is the Stiris cases that we alluded to that increase the coverage.

I think this has been one of the really great panels we have ever had before this committee since I have been here. You have been very helpful, very practical, talk our language. You speak American, and that is something we do not encounter too often.

Am I hearing you say to us that, yes, we do have a problem? The gentleman from Kansas pointed up that even the value of the dollar, the yen, and the pound eases into it, and you have so many complications there.

Are you telling us that you really believe we ought to leave it to your State legislatures to take a shot at it this next year before you have Federal intervention, but for us to keep an overview on it, and certainly keep an interest in it?

I know in Texas, we are unique in so many ways, but one of the ways is that we have a committee there, a blue-ribbon committee that is ahead of the hounds, and doing some work now. Are you telling me, Lyndon, that you think we ought to—I ought to hold up my input in this committee to see what we do down there?

Mr. OLSON. In terms of—if you are asking me, yes, sir, I do. But, this is extremely healthy for us as State regulators to talk to you in the Congress, and vice versa, because the truth of the matter is, we at the State level know the banking regulatory system, know the savings and loan regulatory system, but nobody at the Federal level knows a damn thing about insurance regulation.

Mr. HALL. And historically it has been left to the States. The policies are written there, they are enforced there.

Mr. OLSON. We need to be talking.

Mr. SLATTERY. Would the gentleman from Texas yield to me for just 30 seconds?

Mr. HALL. I yield to you.

Mr. SLATTERY. One of the things that I am concerned about is, in smaller markets in this country, whether it is realistic to expect a State insurance regulator to be able to regulate a market, in effect, that in some cases may be so small as to not be a viable market for major insurance companies. Do you see what I am saying?

Mr. WASHBURN. What do you mean by regulate?

Mr. SLATTERY. Well, the insurance commissioner in Kansas, for example, could conceivably set regulations on insurance companies

that are perhaps providing liability coverage in Kansas. Or the State legislature, for that matter, could pass laws or fail to pass laws that would make it extremely difficult for any insurance provider that is involved in the national markets to provide the kind of coverage that perhaps is needed in the State of Kansas. Do you see what I am saying?

In other words, is it realistic to continue to expect State legislatures, especially in smaller States, to be able to set an environment and create an environment where the insurance industry can come in and be competitive in the national markets?

Mr. OLSON. Because of the interstate commerce—because of the interstate nature of the insurance business, is it realistic? Is the question you are asking, is it realistic——

Mr. SLATTERY. Right. I mean, for example, I do not know whether there are—how many insurance companies in Kansas, for example, that want to insure Boeing, or Cessna, or Beech, or Lear, and they all have major production facilities in Kansas. I do not know many insurance companies in Kansas that do business in Kansas exclusively, for example, that are interested in insuring some of the smaller manufacturers in Kansas.

And yet, the State legislature in Kansas, may or may not pass laws that are needed to enable the insurance companies to continue to do business in the State. Do you see what I am saying?

Mr. OLSON. That is a function of tort though. You have to segregate tort, the judicial responsibility——

Mr. SLATTERY. Well, it is also a function of some of the things that we have talked about in terms of the ability to limit liability contractually.

Mr. OLSON. I understand that. But, by and large, whoever is going to insure Boeing—Boeing may have their own captives or self-contained, and then reinsure themselves.

Mr. SLATTERY. I do not know what their individual insurance situation is.

Mr. OLSON. Or your aggregates—but, by and large, most of those carriers that are going to insure those are probably going to be—it is an interesting regulatory scheme in this Nation because those companies probably are going to be licensed in Illinois, in Maryland, in Florida, in Texas. And all of us—in fact, we have got one company right now, seven of us are on it like a duck on a June bug, and we got notice of it being in trouble before its domestic commissioner did, picked up the phone and called, and jumped on it.

So as a practical matter, the tort—the legislation that would emanate would affect the judicial outcome, potential judicial outcome. But as to any sanctions against the insurers, if those sanctions were so stringent, then that insurance company very likely would redomesticate in Texas because that is the best place to be.

Mr. HALL. One last question, Mr. Chairman.

Mr. FLORIO. The gentleman from Texas.

Mr. HALL. From a practical standpoint, too, whatever really happened to that old-time district judge that could see a lawyer that was obviously better than the defense lawyer or better than the plaintiff's lawyer, and could see an injustice had been done—whether a claimant got too little or got too much.

Whatever happened—and I have had it happen to me—that the judge gets you back in his chambers and says, look, you got $300,000 and you and I both know that case is worth about $150,000. You got the jury to rocking and reeling and crying and spitting in their hand and they gave you a bunch of money. Whatever happened to that old judge that gets both of them in there and says, now, look, Mr. Olson, you did a super job, but I may grant a new trial. I am thinking about granting a new trial unless you file or you remit or you agree to lessen this judgment a little bit?

That would be some help to you too, if we had that approach from the judiciary. Rather than an approach by some judges that I have read about that let the court get away from them, let the lawyers get away from them. That would be helpful, would it not?

Mr. OLSON. Yes, sir; it sure would.

Mr. HALL. Any help I can give you, I am trying to do it.

Thank you, Mr. Chairman.

Mr. FLORIO. Sounds like somebody is campaigning for judgeship.

Let me express the appreciation—I think we have all made it clear that we have been very much impressed by your knowledge and your ability to communicate your knowledge to us in this very difficult field.

And we certainly do appreciate your presence today, and are going to take advantage, quite frankly, of your willingness to provide us with information. And we may stay in contact with you when other questions come up. So thank you very much.

Mr. MUHL. We were just ready to extend that offer to you, Mr. Chairman. We are appreciative for you asking us to appear, and we want to keep those lines of communication open. I think it is important for both of us, as well as the people we serve. Thank you very much.

Mr. FLORIO. Thank you very much.

We have as our final witness—and we apologize for the delay, but as I think you all appreciate, it was a productive morning—Mr. Richard Heydinger, vice president, governmental affairs of the Risk and Insurance Management Society of New York, NY.

Sir, we welcome you. Your statement will be made a part of the record in its entirety. You may feel free to proceed in a summary fashion.

STATEMENT OF RICHARD C. HEYDINGER, VICE PRESIDENT, GOVERNMENTAL AFFAIRS, RISK AND INSURANCE MANAGEMENT SOCIETY, INC.

Mr. HEYDINGER. Thank you. Mr. Chairman, members of the subcommittee, and ladies and gentlemen. I thank you for this opportunity to share a few moments and comments regarding a risk manager's view of this commercial property and casualty insurance market conditions.

I am Dick Heydinger, risk management director for Hallmark Cards in Kansas City, and a member of the executive committee of RIMS, the Risk and Insurance Management Society.

RIMS is a not-for-profit organization representing 3,800 corporate commercial insurance consumers in all segments of the economy, large and small, and of all exposures.

You have my complete testimony, so I am just going to highlight it in the next few minutes.

I guess the best way to highlight the property and casualty insurance marketplace from a commercial insurance consumer's viewpoint is to describe it as chaotic. I never have seen anything like it.

All our members, whether large or small are reporting cancellation and nonrenewal notices, insufficient limits of protection, premium increases that are often multiples of expiring rates, and renewal underwriting terms that are often grossly inadequate to transfer risks that in the past were commonly shifted to insurers.

Now in my testimony I provided some real life examples of the hard market impact on Hallmark Cards, a company that I would hasten to add is not involved in businesses with long-tail, latent liability exposures that so concern insurers. The particular example used was our excess general liability program.

Very briefly, in 1984, we were able to buy a broad cover with limits of $500 million at costs that averaged under $1,000 per million of coverage. For 1985 we could only buy half the limits, $250 million at twice the cost. And for January 1, 1986, we have only been able to buy $75 to $80 million at four times the cost of 1984 coverage.

In summary, limits will be less than 20 percent of 1984, costs will increase by 400 percent, and coverage will be much more restricted.

My testimony also pointed to a survey conducted in the third quarter of 1985 covering 43 excess liability renewal programs of a wide range of risks. The findings indicated that 1985 limits were only 41 percent of 1984 limits. The average cost per million dollars of limits had risen sharply, 805 percent, from $2,500 per million roughly to $23,000 per million.

And then additionally, with your permission, Mr. Chairman, we would like to supplement our testimony today in approximately 2 weeks with the tabulated results of an insurance unavailability survey just recently conducted in January of our membership. For today, I would just like to share a few preliminary findings with you verbally.

We had approximately 1,200 corporations respond to that survey. And Mr. Lent had the question earlier, and I think this directly responds to it. It is quite apparent to us that the insurance availability and affordability crisis applies to all segments of the economy indiscriminately, large or small, regardless of that particular industry classification or exposure represented.

For example, 44 of the respondents in our survey had revenues in excess of $20 billion, so they are big business. And of those, over half reported severe difficulties in obtaining insurance. So that notion that big business can leverage its way out of this problem through buying power is really a misconception.

Also in the area of excess liability insurance, 64 percent of all respondents to the survey reported premium increases exceeding 200 percent. And one-third responded that limits were reduced in excess of one-half of those previously carried.

We summarized the impact of these conditions by making four points. Quickly, first and most obvious is the fact that without adequate levels of insurance, American business cannot operate prudently, cannot protect their crowing asset bases, and cannot offer ample security to its shareholders.

Second, many of our members must do business with vendors that have insufficient coverage. Because RIMS members are often the party best able to pay, they become seriously exposed for others' acts.

Third, the high cost of insuring in the United States adds another burden to this Nation's international trade problem.

Finally, more and more RIMS members are reporting cutbacks. Firms have been forced to abandon products and services with high-risk potential.

In fact, alluding back to our survey, once again, and its findings, it would indicate that over 10 percent of all our members have reduced some segment of its business operations as a result of insurance unavailability. And just think of the potential impact on GNP and the loss of utilitarian value involved.

RIMS traces the negative situation to two primary causes. First, we believe that the fundamental problem lies in the industry's failure to better manage its affairs. It was poor management which led to cash flow underwriting and the decline of underwriting skills. We suggest that the industry restore underwriting disciplines, and carefully worded, artful policies that reduce misinterpretation.

Unfortunately, the insurance industry's definition of underwriting discipline has come in the form of untimely imposition of the claims-made approach to the general liability insurance policy.

Although several modifications to the original policy proposal have been made, RIMS remains deeply concerned about the serious coverage deterioration that has taken place, and is equally concerned with the potential for abuse by the industry in the handling of such matters as discovery periods, retroactive dates, and endorsements. You have our full position statement on that subject.

And second, we share the view that the U.S. tort liability system is a major contributor to the overall problem. This system, in our judgment, should undergo significant reform.

Our greatest anxiety, however, comes from the recognition that meaningful reform will not occur in the short term. And second, that we have no assurance from the industry that if tort reform were accomplished that they would reciprocate by offering adequate and reasonably priced insurance for all risks.

As far as potential solutions, our testimony offered these suggested Federal Government remedies. First, the Federal Government can be instrumental in obtaining that commitment from the insurance industry to restore order to the property and casualty insurance marketplace.

The industry enjoys an exemption from antitrust laws, and must therefore, make diligent efforts to reduce these convulsive cycles and their negative influence on American commerce and our membership's businesses.

Second, Congress should reject the proposed increase in the Federal excise tax on foreign reinsurance, because policyholders nor-

mally pay these taxes directly. It is not really added tax on the industry, but rather added insurance expense.

And third, serious consideration should be given to allowing the banking industry to add much needed capital to the insurance field.

And then last, I would like to suggest two areas in which Congress can bring some competition back into the insurance marketplace, and provide commercial insurance consumers some tools necessary to reduce its dependency on an industry that has demonstrated its inability to reduce corporate uncertainty to acceptable levels.

First, I think Congress should expand the risk retention group concept, which it enacted for dealing with products liability, to include all other liability exposures other than personal lines. Such amendments could facilitate the use of self-insurance, including captive insurance subsidiaries, and provide commercial risk reasonable alternatives to commercial insurance.

And then last, the current U.S. Tax Code caters to the buying of commercial insurance. Commercial premium payments are immediately tax deductible. On the other hand, those people choosing, or being required due to lack of insurance, to self-insure cannot deduct funds set aside for future loss payments until those payments are actually payable or due.

Representative William Frenzel introduced H.R. 2642 in the 98th Congress to correct this disincentive to the use of self-insurance. We encourage the reintroduction of such legislation. It would place insurance premiums and self-insurance costs on equal footing. Passage of this type of bill would provide the corporate insured the desperately needed flexibility to survive in this area of insurance unavailability.

On behalf of RIMS and Hallmark Cards, I thank you all for your time and attention.

[Testimony resumes on p. 685.]

[The prepared statement of Mr. Heydinger and attachments follow:]

65-958 0 - 87 - 20

Risk and Insurance Management Society, Inc.

TESTIMONY OF THE RISK AND INSURANCE MANAGEMENT SOCIETY, INC. (RIMS)

GIVEN BY

RICHARD C. HEYDINGER

RIMS VICE PRESIDENT

GOVERNMENTAL AFFAIRS AND

RISK MANAGEMENT DIRECTOR,

HALLMARK CARDS, INC.

BEFORE

THE U.S. HOUSE OF REPRESENTATIVES SUBCOMMITTEE OF COMMERCE, TRANSPORTATION AND TOURISM, AT ITS HEARING ON THE UNAFFORDABILITY AND UNAVAILABILITY OF LIABILITY INSURANCE, HELD ON FEBRUARY 20, 1986, 9:30 A.M., IN 2322 RAYBURN HOUSE OFFICE BUILDING.

205 East 42nd Street, New York, N Y 10017 • (212) 286-9292
Telex 968289 • FAX (212) 986-9716

MR. CHAIRMAN AND MEMBERS OF THE COMMITTEE I THANK YOU FOR THIS OPPORTUNITY TO SHARE A FEW COMMENTS REGARDING A RISK MANAGER'S VIEW OF THE CURRENT AND DEVELOPING COMMERCIAL PROPERTY AND CASUALTY INSURANCE MARKETPLACE. I AM DICK HEYDINGER, RISK MANAGEMENT DIRECTOR FOR HALLMARK CARDS, INC., THE WORLDS LARGEST MANUFACTURER AND DISTRIBUTOR OF SOCIAL EXPRESSION PRODUCTS, HEADQUARTERED IN KANSAS CITY, MO. I AM ALSO A MEMBER OF THE EXECUTIVE COMMITTEE OF THE RISK AND INSURANCE MANAGEMENT SOCIETY (COMMONLY REFERRED TO AS RIMS) AND SERVE AS ITS CURRENT VICE PRESIDENT-GOVERNMENTAL AFFAIRS. RIMS IS A NON-PROFIT ASSOCIATION FOR RISK AND INSURANCE MANAGERS OF COMMERCIAL AND INDUSTRIAL ENTERPRIZES, PUBLIC ENTITIES AND SERVICE ORGANIZATIONS. OUR 3,800 ORGANIZATIONAL MEMBERS, REPRESENTED IN MORE THAN 76 CHAPTERS THROUGHOUT THE UNITED STATES AND CANADA, INCLUDE NOT ONLY 97% OF THE FORTUNE 500 LIST BUT MANY SMALLER BUSINESSES, TOWNS AND SERVICE ORGANIZATIONS AS WELL.

IN THE NEXT FEW MINUTES, I WOULD LIKE TO SHARE SOME FIRST-HAND HALLMARK EXPERIENCES REGARDING THE AVAILABILITY AND AFFORDABILITY OF PROPERTY AND CASUALTY INSURANCE. IN ADDITION, I WILL BRIEF REPORTS RECEIVED FROM OTHER RIMS MEMBERS ON THEIR FIRMS' DIFFICULTIES IN DEVELOPING PROPER RISK TRANSFER PROGRAMS IN TODAY'S ENVIRONMENT. TO CONCLUDE MY REPORT, I WILL SUGGEST SOME POSSIBLE SHORT-TERM AND LONG-TERM SOLUTIONS THAT WE AT RIMS AND HALLMARK ARE EXPLORING AS POSSIBLE MEANS OF RELIEF.

AVAILABILITY/AFFORDABILITY

IN ALL FRANKNESS, THE COMMERCIAL PROPERTY/CASUALTY MARKETPLACE IS CHAOTIC. I DO NOT KNOW OF ANY LARGE COMMERCIAL BUSINESS THAT HAS NOT EXPERIENCED

CANCELLATION AND NON-RENEWAL NOTICES; INSUFFICIENT AVAILABLE LIMITS AND MARKETS, PREMIUM INCREASES THAT ARE OFTEN LARGE MULTIPLES OF EXPIRING RATES; AND COVERAGE THAT IS GROSSLY INADEQUATE. POLICYHOLDERS ARE LEFT WITH A TREMENDOUS AMOUNT OF RISK THAT JUST A FEW SHORT MONTHS AGO WAS READILY TRANSFERRED TO THE INSURANCE MECHANISM.

THE MOST DISCONCERTING ASPECT OF THIS SITUATION APPEARS TO BE THAT INSURANCE AVAILABILITY IS RAPIDLY DETERIORATING. INFORMAL SURVEYS OF OUR MEMBERS INDICATE THAT POLICYHOLDERS WITH CASUALTY RENEWALS IN JULY AND OCTOBER OF 1985 WERE SIGNIFICANTLY BETTER OFF THAN THOSE TRYING TO REPLACE PROGRAMS EXPIRING DECEMBER 1, 1985 OR JANUARY 1, 1986. WITH THE ASSISTANCE OF OUR INSURANCE BROKER, HALLMARK KEEPS A RUNNING SCHEDULE OF ALL CASUALTY CARRIERS POTENTIALLY AVAILABLE FOR PARTICIPATION IN OUR UMBRELLA/EXCESS LIABILITY PROGRAM. MONTH BY MONTH, WE HAVE SEEN THE NUMBER OF LIKELY CARRIERS SHRINK AND THOSE THAT DO REMAIN, HAVE ADDED FURTHER UNDERWRITING RESTRICTIONS.

TO GIVE YOU AN EXAMPLE OF THE "HARD MARKET" IMPACT ON HALLMARK, LET ME EXPLAIN THE LIABILITY UMBRELLA/EXCESS COVERAGE PROGRAM I JUST MENTIONED. AS YOU CAN SURMISE FROM TRIPS TO YOUR LOCAL HALLMARK SOCIAL EXPRESSION SHOP, HALLMARK IS NOT INVOLVED IN A BUSINESS WITH THE LONG-TAIL, LATENT LIABILITY EXPOSURES WITH WHICH THAT THE INSURANCE INDUSTRY IS SO CONCERNED.

FOR THE MOST PART, WE SELF-INSURE OUR NORMAL WORK-DAY LOSSES SUCH AS WORKERS' COMPENSATION, AUTOMOBILE ACCIDENTS, AND SLIPS, TRIPS AND FALLS ON

HALLMARK PREMISES. WE LOOK TO THE PROFESSIONAL LIABILITY INSURER TO PROVIDE COVERAGE FOR THE UNPREDICTABLE, LOW-PROBABILITY, BUT HIGH-SEVERITY, TYPE OF EXPOSURES CONFRONTING ALL WORLDWIDE OPERATIONS.

TWO YEARS AGO, AS WE DEVELOPED OUR 1984 LIABILITY PROGRAM, WE FOUND A VERY RESPONSIVE CASUALTY MARKETPLACE. THERE WERE NUMEROUS INSURERS, OFFERING BROAD TERMS AND QUITE AFFORDABLE RATES. APPROXIMATELY $800 MILLION IN LIMITS WERE AVAILABLE TO HALLMARK. WE WERE ABLE TO SORT THROUGH THE VARIOUS INSURERS AND CHOOSE THOSE THAT OFFERED THE HIGHEST QUALITY FINANCIAL SECURITY AND HAD THE BEST TRACK RECORDS FOR WILLINGNESS TO PAY LOSSES. THE RESULT WAS A $500-MILLION PROGRAM, WITH HIGHLY-RATED CARRIERS ALL USING THE SAME BROAD, OCCURRENCE-BASED POLICIES, AT A TOTAL COST THAT AVERAGED LESS THAN $1,000 PER $1 MILLION OF LIMITS.

ONE YEAR AGO, AS WE ATTEMPTED TO RENEW THE PROGRAM FOR 1985, WE WERE QUITE ALARMED TO WITNESS THE EARLY EMERGENCE OF A NEW "HARD MARKET" CYCLE. BY EARLY MARCH 1985, WHEN WE FINALLY COMPLETED OUR JANUARY 1ST RENEWAL, WE FOUND THAT BY COMBINING ALL POSSIBLE SUPPLIERS (MANY OF WHOM HAD DETERIORATING FINANCIAL STATEMENTS AND DECLINING BEST'S RATINGS), WE WERE ABLE TO BUY ONLY HALF THE LIMIT, $250 MILLION, AT TWICE OUR 1984 COST AND WITH NUMEROUS COVERAGE RESTRICTIONS. DURING THE COURSE OF 1985, SOME OF OUR PROGRAM PARTICIPANTS SHOULD HAVE BEEN REPLACED BECAUSE THEIR FINANCIAL STRENGTH HAD BEEN CALLED INTO QUESTION OR THEY HAD ISSUED CANCELLATION NOTICES. IN ATTEMPTING TO DO SO, HOWEVER, WE COULD FIND NO WILLING SUBSTITUTES.

TRYING TO RENEW OUR 1986 PROGRAM HAS BEEN PAINSTAKINGLY SLOW AND HAS PRODUCED UTTER FRUSTRATION. ON JANUARY 1, OUR PROGRAM RENEWAL DATE, WE WERE ABLE TO OBTAIN COMMITMENTS FOR ONLY $1.5 MILLION IN COVERAGE.

AT THIS POINT IN TIME, SOME SEVEN WEEKS AFTER OUR RENEWAL DATE, LIMITS AVAILABLE FROM THE ENTIRE CONVENTIONAL MARKET IS BETWEEN $75 AND $80 MILLION, COMPARED TO $800 MILLION IN LIMITS IN 1985, COSTING FOUR TIMES LESS. TO MAKE MATTERS WORSE, THE COVERAGE ITSELF IS SEVERELY REDUCED, AS WE HAVE RECEIVED A LONG LIST OF EXCLUSIONS AND RESTRICTIONS.

AND THERE HAVE BEEN OTHER TROUBLES IN OBTAINING COVERAGE FOR HALLMARK. ATTEMPTS TO RENEW OUR ENVIRONMENTAL LIABILITY PROGRAM FOUND ONLY ONE WILLING SELLER. THIS SELLER OFFERED HALF THE EXPIRING LIMIT AT FIVE TIMES THE EXPIRING COST, AND RESTRICTED THE COVERAGE TO NOT APPLY TO CLAIMS OUTSIDE OUR PREMISES. WE PAID FOUR TIMES AS MUCH PREMIUM FOR ONLY HALF THE DIRECTORS AND OFFICERS LIABILITY LIMITS. IN 1986, ONLY 40 PERCENT OF THE FIDUCIARY LIABILITY LIMITS PREVIOUSLY CARRIED WERE AVAILABLE--REGARDLESS OF PRICE. OUR FIRST-PARTY PROPERTY INSURANCE PROGRAMS HAVE ALSO BEEN AFFECTED. COSTS ARE RISING SHARPLY AS REINSURERS RETREAT FROM LOCATIONS WITH HIGH-VALUED EXPOSURES AND SPECIAL-LOSS EXPOSURES SUCH AS FLOOD OR PLASTIC-FIRE RISKS.

TO BROADEN THE PERSPECTIVE, I WOULD LIKE TO SHARE THE RESULTS OF A THIRD-QUARTER-EXCESS-LIABILITY-RENEWAL SURVEY CONDUCTED IN EARLY NOVEMBER BY A LARGE NATIONAL INSURANCE BROKER, MARSH & MCLENNAN, INC. THEY ASKED THEIR VARIOUS UNITED STATES OFFICES TO SUPPLY INFORMATION ON THOSE LARGE COMMER-

CIAL CLIENTS WHICH EXPERIENCED EXCESS LIABILITY RENEWALS IN THE THIRD QUARTER OF 1985. THE SURVEY INCLUDED 43 PROGRAMS WITH PARTICIPANTS--MANUFACTURERS, FINANCIAL INSTITUTIONS, RETAILERS, CONTRACTORS, UTILITIES, CONGLOMERATES, PHARMACEUTICALS--REPRESENTING WIDE RANGE OF RISKS. THE OIL AND ENERGY INDUSTRIES WERE SPARSELY REPRESENTED. THE SURVEY FOUND 1985 LIMITS TO BE ONLY 41 PERCENT OF 1984 LIMITS. THE 1984 AVERAGE COST PER MILLION DOLLARS OF COVERAGE WAS $2,570 WHEREAS THE 1985 AVERAGE COST PER MILLION HAD RISEN SHARPLY TO $23,260, AN AVERAGE INCREASE OF 805%. THIS SURVEY DOES NOT ATTEMPT TO MEASURE THE REDUCTION IN PROTECTION REPRESENTED BY THE MORE RESTRICTIVE 1985 POLICY CONDITIONS. IN SUMMARY, THE AVAILABILITY/AFFORDABILITY PROBLEM IS REAL AND WIDESPREAD. THE LIST OF PROBLEM COVERAGES INCREASES WEEKLY, AFFECTING ALL SECTORS OF OUR ECONOMY, WHETHER LARGE OR SMALL.

POTENTIAL IMPACT ON RIMS MEMBERS

THESE DRASTIC PRICE INCREASES AND COVERAGE RESTRICTIONS HAVE FAR-REACHING EFFECTS ON AMERICAN BUSINESS AND OUR MEMBERSHIP.

FIRST, AND MOST OBVIOUS IS THE FACT THAT WITHOUT ADEQUATE LEVELS OF INSURANCE, OUR MEMBERS CANNOT OPERATE THEIR BUSINESSES PRUDENTLY, CANNOT PROTECT THEIR GROWING ASSET BASES NOR OFFER AMPLE SECURITY TO THEIR STOCKHOLDERS. THE INADEQUATE LIMITS OFFERED BY THE CONVENTIONAL MARKETPLACE, THE PROSPECT THAT MANY CARRIERS DO NOT HAVE THE ABILITY TO PAY LARGE LOSSES, AND THE GENERAL OPERATING PLAN OF MANY INSURERS TO ACCEPT ONLY THE MOST INNOCUOUS RISKS IS SIMPLY UNACCEPTABLE FOR OUR NEEDS.

SECOND, MANY OF OUR MEMBER FIRMS RELY ON SMALL SUPPLIERS OF MATERIALS AND SERVICES--SUCH AS WASTE DISPOSAL FIRMS, MOTOR TRUCK CARRIERS, AND PLANT PHYSICIANS--THAT ARE INADEQUATELY INSURED AND COULD NOT REACT RESPONSIBLY TO LOSSES ARISING FROM THEIR PRODUCTS AND SERVICES. EACH WEEK, WE ARE FACED TO DO'NG BUSINESS WITH MORE AND MORE VENDORS WITH INSUFFICIENT INSURANCE CLAIMS. BECAUSE OUR MEMBERS ARE OFTEN THE PARTY "BEST ABLE TO PAY", THEY ARE SERIOUSLY EXPOSED TO LIABILITY RISKS RESULTING FROM THEIR VENDORS' ACTIONS.

THIRD, WE ARE FACED WITH ABSORBING PRECIPITOUS PREMIUM INCREASES AND POTENTIAL UNINSURED LOSSES WHICH HAS SERIOUS IMPLICATIONS IN THE COMPETITIVE MARKETPLACE. THE HIGH COST OF INSURING IN AMERICA CAN ONLY ADD ANOTHER BURDEN TO THE NATION'S INTERNATIONAL TRADE PROBLEM.

LAST, DUE TO THE FAILURE OF THE CONVENTIONAL INSURANCE INDUSTRY TO PROVIDE NEEDED SECURITY, MANY OF OUR FIRMS HAVE BEEN REQUIRED TO DEVOTE EXTENSIVE ENERGY, MANAGEMENT TALENT AND SCARCE CAPITAL DOLLARS TO THE DEVELOPMENT OF NON-TRADITIONAL RISK-FINANCING ALTERNATIVES. HALLMARK HAS JOINED WITH OTHER AMERICAN BUSINESSES IN CAPITALIZING NEW INSURANCE C PANIES DESIGNED TO INSURE ITS INVESTORS' RISKS. WE RELUCTANTLY ENTER THE "INSURANCE BUSINESS" NOT BECAUSE WE THINK WE CAN DO BETTER THAN THE EXPERTS, BUT BECAUSE THEY SIMPLY HAVE LEFT US NO CHOICE.

THE OTHER POTENTIAL IMPLICATIONS MOST MENTIONED BY PIMS MEMBERS ARE THESE. THERE IS A GROWING CONCERN AMONG BUSINESSES THAT AS THE POTENTIAL FOR EXPOSURE TO LOSS NCREASES DUE TO COVERAGE AND CAPACITY CURTAILMENT, THE PO-

TENTIAL FOR UNCOMPENSATED AMERICAN VICTIMS RISES. AND THERE ARE MORE AND MORE INSTANCES OF COMPANIES BEING FORCED TO FOREGO EXISTING PRODUCT LINES, PROMISING RESEARCH PROJECTS OR EXPANSION PLANS IN AREAS THAT REPRESENT HIGH-RISK POTENTIAL.

RIMS IS GREATLY CONCERNED ABOUT THE NEW CLAIMS-MADE COMPREHENSIVE GENERAL LIABILITY (CGL) POLICY. UNLIKE MANY SECTORS OF THE INSURANCE-CARRIER COMMUNITY, RIMS DOES NOT SEE IT, AS A SOLUTION TO THE INSURANCE AVAILABILITY PROBLEM. THIS CGL POLICY IS THE FOUNDATION OF COMMERCIAL INSURANCE SOLD IN THE UNITED STATES. FOR REASONS EXPLAINED MORE FULLY IN THE ATTACHED POSITION PAPER, RIMS HAS GRAVE RESERVATIONS ABOUT THE QUALITY, SCOPE, AND CONTINUITY OF COVERAGE OFFERED TO THE POLICYHOLDER UNDER THE NEW CGL FORM. WHILE RIMS HOPES TO BE PROVEN WRONG ABOUT THE EFFICACY OF THE CLAIMS-MADE CGL, WE FEEL STRONGLY THAT THIS POLICY REFLECTS THE FAILURE OF THE CURRENT INSURANCE MARKETPLACE. IT IS NOT A SOLUTION TO THE INSURANCE AVAILABILITY CRISIS.

<u>CAUSES</u>

1. <u>CASH FLOW UNDERWRITING</u>

THE INDUSTRY IS QUICK TO POINT ITS FINGER TO EXTERNAL CAUSES OF ITS WOES. WE AGREE EXTERNAL FACTORS ARE THERE, HOWEVER, WE ALSO BELIEVE THAT THE FUNDAMENTAL PROBLEM LIES IN THE INDUSTRY'S FAILURE TO BETTER MANAGE ITS AFFAIRS AND TO REDUCE THE SEVERITY OF THE WIDE PROFIT AND LOSS CYCLES THAT PLAGUE THE PROPERTY/CASUALTY INDUSTRY IN MODERN TIMES. WE THINK IT WAS POOR MANAGEMENT WHICH LED TO THE CASH-

FLOW-UNDERWRITING AND MARKET-SHARE MENTALITY AND THE ACCOMPANYING DECLINE OF UNDERWRITING SKILLS.

WE BELIEVE THE INDUSTRY WHEN IT REPORTS UNDERWRITING LOSSES FOR THE YEARS 1982-84 THAT AMOUNTED TO MORE THAN $34 BILLION, SURPASSING THE TOTAL OF ALL LOSSES FOR THE PREVIOUS 25 YEARS. IN FACT, WE ARE QUITE CONCERNED WHETHER THE CONTINGENCY RESERVES ESTABLISHED BY THE INDUSTRY ARE REALLY SUFFICIENT TO COVER RUN-OFF LIABILITIES. PERHAPS THEY NEED TO BE FURTHER STRENGTHENED AS THE NEW ROUND OF PRICE INCREASES MAKES ITS WAY TO THE BOTTOM LINE OF THE PROFIT-AND-LOSS STATEMENTS. AT THIS POINT, WE BELIEVE THAT THE INDUSTRY COULD DO MUCH TO IMPROVE ITS STATE BY RETURNING TO BASIC RISK-SELECTION AND PRICING TECHNIQUES BY BRINGING THOSE UNDERWRITERS AND ACTUARIES OUT OF THE CLOSET AND BY DEVOTING THE TIME REQUIRED TO WRITE CAREFULLY WORDED, ARTFUL POLICIES IN ORDER TO REDUCE MISINTERPRETATION BY THE COURTS.

2. <u>CIVIL JUSTICE SYSTEM</u>

SOME HAVE CHARGED THE INSURANCE INDUSTRY WITH WITHHOLDING CAPACITY IN ORDER TO SPUR TORT REFORM. THE INSURANCE INDUSTRY IS NEITHER SMART ENOUGH OR STUPID ENOUGH TO ADOPT THIS TACTIC. CIVIL JUSTICE REFORM, WHILE ABSOLUTELY ESSENTIAL, IS NOT SOMETHING TO BE EFFECTED FOR THE BENEFIT OF THE INSURANCE CARRIER. INSURANCE IS SIMPLY A METHOD OF RISK TRANSFER WHICH OPERATES THROUGH THE LAW OF LARGE NUMBERS TO BROADLY SPREAD THAT RISK. THE INSURANCE MECHANISM WILL NOT BAIL OUT A CIVIL JUSTICE SYSTEM THAT OFTEN EXPENDS MORE FOR COURT COSTS AND

LEGAL FEES THAN IT COMPENSATES LEGITIMATE CLAIMANTS. NOR IS INSURANCE THE FUNDING SOURCE OF OUR EMERGING BODY OF LAW THAT MOVES THE ROLE OF TORT LAW FROM ONE OF EQUITY TO ONE WHICH ATTEMPTS TO COMPENSATE ALL INJURY REGARDLESS OF NEGLIGENCE. WHILE THE INSURANCE COMPANIES MAY BE THE FRONT LINE CASUALTIES OF SUCH A SYSTEM OF CIVIL JUSTICE, THEY ARE NOT THE ULTIMATE LOSERS. THESE LOSERS ARE GYNECOLOGISTS WHO NO LONGER PRACTICE OBSTRETICS BECAUSE OF RISING MALPRACTICE RATES; LOCAL GOVERNMENTS WHO CANNOT KEEP QUALIFIED PUBLIC OFFICIALS, BECAUSE THEY CANNOT INDEMNIFY THESE INDIVIDUALS SHOULD THEY BE SUED; TRUCKING COMPANIES WHO ARE MAKING FEWER RUNS BECAUSE INSURANCE IS UNAVAILABLE, BUSINESSES WHO TURN AWAY FROM PROMISING AREAS OF COMMERCE AND RESEARCH BECAUSE POTENTIAL LIABILITY EXPOSURES ARE TOO GREAT; ASBESTOS VICTIMS WHO ONLY RECEIVE A LITTLE MORE THAN 35 CENTS OF EVERY DOLLAR EXPENDED IN PROCESSING THEIR CLAIMS THROUGH THE PRESENT CIVIL JUSTICE SYSTEM; AND EVERY CONSUMER OF PRODUCTS AND SERVICES IN THIS NATION WHO IS ULTIMATELY SHOULDERING THE BURDEN OF OUR INEQUITABLE AND INEFFICIENT CIVIL JUSTICE SYSTEM.

3. EFFECTIVENESS OF STATE REGULATION

MANY ARE TAKING THIS OPPORTUNITY TO DESIGNATE INADEQUATE STATE REGULATION AS A MAJOR CONTRIBUTOR TO THE RECURRING PROBLEM OF THE INDUSTRY. FOR THE MOST PART, RIMS FINDS STATE REGULATORY PERSONNEL VERY CAPABLE, SINCERE AND RESPONSIVE TO OUR MEMBERS CONCERNS. MANY INSURANCE RELATED CONCERNS ARE REGIONAL IN NATURE AND ARE BEST DEALT

WITH BY A STATE MECHANISM. WE DO FIND, HOWEVER, THAT MOST STATE REGULATORY BODIES HAVE A TREMENDOUS SHORTAGE OF MANPOWER AND RESOURCES. WE HAVE LONG BEEN AN ADVOCATE FOR RETURNING A MUCH LARGER SHARE OF THE STATE INSURANCE PREMIUM TAX REVENUES (MUCH OF WHICH WE CONTRIBUTE AS COMMERCIAL CONSUMERS) TO THE STATE INSURANCE DEPARTMENT.

IN THE COMMERCIAL AREA, REGULATION SHOULD FOCUS ON (1) THE EARLY DETECTION OF FINANCIAL DIFFICULTIES OF INDIVIDUAL COMPANIES, (2) ENFORCEMENT OF RULES AND LAWS AGAINST BOYCOTTS AND OTHER UNFAIR TRADE PRACTICES AND (3) THE ESTABLISHMENT OF MINIMUM STANDARDS OF COMPETENCE AND CONDUCT FOR INSURANCE COMPANIES, AGENTS, BROKERS AND CONSULTANTS.

SOLUTIONS

1. CONTINUED CONGRESSIONAL OVERSIGHT

ANYONE LOOKING FOR A SINGLE QUICK-FIX ANSWER TO THE INSURANCE AVAILABILITY CRISIS WILL BE DISAPPOINTED. THE CRISIS WE ARE IN TODAY IS LARGELY THE RESULT OF YEARS OF INSURANCE-CARRIER CASH-FLOW UNDERWRITING AND A CIVIL JUSTICE SYSTEM IN NEED OF REFORM. WHILE RIMS WILL OFFER THE FORMAL RESULTS OF OUR INSURANCE-AVAILABILITY SURVEY NEXT MONTH, WE WILL SHARE TODAY, THE ANECTDOTAL EXPERIENCES HEARD FROM RISK MANAGERS OF INSURANCE CARRIERS SEEKING TO EXPLOIT, RATHER THAN REMEDY THE PRESENT INSURANCE MARKETPLACE CHAOS.

A GOOD DESCRIPTION OF WHAT IS HAPPENING IN MANY QUARTERS OF THE MARKETPLACE WAS OFFERED BY ROBERT J. CLARK, THE CHAIRMAN OF THE INSURANCE SERVICES OFFICE, INC. (ISO) AND PRESIDENT, COMMERCIAL INSURANCE DIVISION OF AETNA LIFE AND CASUALTY COMPANY, BEFORE THE ANNUAL MEETING OF ISO, JANUARY 4, 1986:

"AS IMPORTANT AS IT IS FOR US TO TAKE THE LEAD IN CIVIL JUSTICE REFORM, THERE ARE THINGS I THINK WE NEED TO CORRECT FIRST WITHIN OUR OWN INDUSTRY. IF WE DON'T CORRECT THEM, WE WILL LACK THE CREDIBILITY WE NEED TO EFFECT CHANGE IN THE OUTSIDE WORLD. I'M PEFERRING TO CERTAIN ACTIONS SOME OF US TEND TO TAKE IN A TIGHT COMMERCIAL MARKET--SUCH AS CANCELLING POLICIES MID-TERM; NON RENEWING WITHOUT ADEQUATE NOTICE; RAISING PRICES TO UNREASONABLY HIGH LEVELS; CUTTING OFF CLASSES OF INSURANCE WITHOUT SOLID UNDERWRITING REASONS, BASING PRICING AND UNDERWPITING JUDGMENTS ON WORSE CASE SCENARIOS; AND JUST GENERALLY ACTING ON FEAR RATHER THAN ON FACT.

I'M NOT SUGGESTING THAT EVERYONE HAS INDULGED IN THESE EXCESSES--OR HAS DONE SO TO THE SAME DEGREE. BUT TO THE EXTENT THEY ARE HAPPENING, I HOPE ALL OF US--RIGHT HERE AND NOW--WILL MAKE A COMMITMENT TO CURB THEM."

RIMS HOPES THAT INSURANCE INDUSTRY SELF RESTRAINT AND THE DEMONSTRATED CONCERN OF THE STATE REGULATORY COMMUNITY WILL CURB THESE EXCESSES. NEVERTHELESS, THE NUMEROUS HEARINGS HELD IN CONGRESS ON INSURANCE AVAILABILITY HAS HAD THE SALUTORY EFFECT OF REMINDING THE IN-

DUSTRY THAT THE McCARRON FERGUSON ANTI-TRUST EXEMPTION IS A PRIVILEGE, NOT A RIGHT, AND WHILE THE FEDERAL GOVERNMENT DEFERS TO THE STATES IN THE REGULATION OF INSURANCE, IT DOES NOT ABDICATE RESPONSIBILILTY. RIMS FIRMLY BELIEVES IN THE VIABILITY OF STATE REGULATION OF INSURANCE. THIS VIABILITY IS ENHANCED, NOT UNDERMINED, BY CONTINUED CONGRESSIONAL HEARINGS AND SUPERVISION. CONGRESSMAN FLORIO AND THIS SUBCOMMITTEE ARE TO BE COMMENDED FOR ITS OUTSTANDING EFFORTS IN THIS REGARD.

2. CIVIL JUSTICE REFORM

OUR VERY GENERAL AND BRIEF CONCEPT OF PRIORITIES ON TORT REFORM ARE THESE: REFORM SHOULD BE BROAD-BASED AND GIVE EQUAL PROTECTION TO ALL INDUSTRIES, NOT JUST SELECTED SECTORS SUCH AS THE MEDICAL PROFESSION OR PRODUCT MANUFACTURERS. THE JUDICIAL REFORMS MUST BE MADE TO ALLOW THE ESCALATING AMOUNTS OF LITIGATION TO BE PROCESSED WITH GREATER EFFICIENCY AND LOWER COST.

THE EXCESSES ENCOURAGED BY THE CONTINGENCY FEE SYSTEM MUST BE CURBED WITHOUT CAUSING UNFAIR RESTRICTION TO THOSE SECTORS OF SOCIETY WISHING TO ACCESS OUR TORT SYSTEM. REALISTIC CAPS SHOULD BE PLACED ON NON-ECONOMIC DAMAGES. PUNITIVE DAMAGES SHOULD BE SHIFTED FROM THE CIVIL SYSTEM TO THE CRIMINAL SYSTEM WHERE THEY CAN BE MORE APPROPRIATELY HANDED. IT IS TIME FOR STATUTORY REPLACEMENT OF SOME OF OUR ORIGINAL THEORIES OF NEGLIGENCE THAT IN RECENT TIMES HAVE BEEN CAST ASIDE BY A SYSTEM DESIGNED TO REMEDY SOCIETAL PROBLEMS REGARDLESS OF THE DEFENDANT'S FAULT.

As stated earlier, tort reform should be viewed as a long-term societal need, not just a quick fix for insurance unavailability. Nonetheless, the insurance industry should be expected to offer a commitment of coverage availability if civil justice reform is effectuated. To again quote Robert Clarke of Aetna:

"I've mentioned what might happen if we don't succeed in achieving reform. Even more important, I think, is what will happen if we do succeed. I believe it is absolutely critical that we make a commitment--both as an industry and as individual companies--that if we are successful in this endeavor, we will make insurance available for most, if not all of the areas where availability is currently a problem. We cannot--must not--use the availability issue as a reason to reform the civil system and then not respond when reforms are achieved. Are we willing to make that commitment? To me, this is the acid test of our worthiness to be the catalyst for change".

3. <u>Congress should reject a tax hike on reinsurance ceded abroad</u>

The House-passed tax reform bill contains a provision which hikes the tax on reinsurance ceded abroad from one to four percent. It must be understood that even before the current insurance capacity crunch, United States property casualty insurers reinsure much of the risks they assume abroad. The reality of the insurance transaction is that it will be the policyholder, not the insurer or reinsurer who will

SHOULDER, DIRECTLY OR INDIRECTLY, THE BURDEN OF THIS TAX INCREASE. IT MAKES NO SENSE TO EXACERBATE THE ALREADY RAPIDLY ESCALATAING PREMIUMS BY ADDING WHAT IS SURE TO BE A 3% PASS THROUGH COST. IT MAKES EVEN LESS SENSE TO INCREASE THE TRANSACTION COSTS OF INTERNATIONAL INSURANCE DEALINGS, WHEN DOMESTIC INSURANCE CAPACITY IS WOEFULLY INADEQUATE TO MEET THE NEEDS OF U.S. BUSINESSES, PUBLIC ENTITIES AND INSTITUTIONS.

4. <u>BANKS IN INSURANCE</u>

THE INSURANCE SERVICES OFFICE (ISO) HAS PROJECTED A $62 BILLION SHORTFALL IN COMMERCIAL INSURANCE CAPACITY OVER THE NEXT FIVE YEARS. THE ENTRY OF BANKS INTO INSURANCE SHOULD <u>NOT</u> BE VIEWED AS A SHORT-TERM FIX TO THIS CAPACITY PROBLEM. THERE ARE MANY REGULATORY PROBLEMS WHICH MUST BE RESOLVED (FOR THE RECORD, A COPY OF THE RIMS TESTIMONY BEFORE THE NEW YORK STATE TEMPORARY COMMISSION ON BANKING, INSURANCE AND FINANCIAL SERVICES IS ENCLOSED). UNFORTUNATELY, THE DEBATE ON BOTH THE FEDERAL AND STATE LEVEL HAS SEEMED TO FOCUS ON WHY BANKS SHOULD NOT BE PERMITTED TO ENGAGE IN INSURANCE ACTIVITIES. RIMS RESPECTFULLY SUBMITS THAT CONGRESS AND THE STATES SHOULD NOW SERIOUSLY CONSIDER WHAT REGULATORY SAFEGUARDS PROTECTING MARKET COMPETITIVENESS, THE BANKING CONSUMER AND THE INSURANCE POLICYHOLDER WOULD BE NEEDED TO PERMIT BANKS TO LEND MUCH-NEEDED CAPACITY TO THE INSURANCE MARKETPLACE.

5. CONGRESS SHOULD FACILITATE THE FORMATION OF CAPTIVE AND RISK RETENTION GROUPS

THE PURCHASE OF INSURANCE IS ONLY ONE OF THE WAYS IN WHICH THE COMMERCIAL INSURED CAN EFFECTIVELY DEAL WITH THE RISK OF LOSS. IF THE INSURED IS LARGE ENOUGH AND/OR HAS A STABLE LOSS HISTORY, HE/SHE MAY SEEK TO ESTABLISH A LOSS RESERVE TO FUND PREDICTABLE FUTURE LOSSES. THIS MAY BE A FAR MORE EFFICIENT ALTERNATIVE FOR THE ENTITY THAN THE PURCHASE OF COMMERCIAL INSURANCE. SIMILARLY, A COMMERCIAL INSURED MAY ESTABLISH AN INSURANCE COMPANY SUBSIDIARY WHICH EXCLUSIVELY HANDLES THE RISK OF THE CORPORATE PARENT. THIS SUBSIDIARY IS CALLED A CAPTIVE. THE CAPTIVE ALTERNATIVE GIVES THE CORPORATE PARENT THE ADDED BENEFIT OF ALLOWING IT TO TAP INTO THE OFTEN LESS EXPENSIVE REINSURANCE MARKET, NORMALLY AVAILABLE TO ONLY PRIMARY INSURERS. OFTEN SEVERAL INSUREDS WILL COME TOGETHER TO FORM A RISK RETENTION GROUP.

UNFORTUNATELY, CONFLICTING STATE INSURANCE LAWS OFTEN MAKE IT MOST DIFFICULT FOR THE INSURED, OR INSUREDS WITH MULTI-STATE OPERATIONS, TO UTILIZE A CAPTIVE. TO QUOTE FROM THE LEGISLATIVE HISTORY OF THE PRODUCT LIABILITY RISK RETENTION ACT OF 1981 (P.L. 97-45):

"THE STATE LAWS HAVE OTHER REGULATORY STANDARDS WHICH MAKE IT DIFFICULT FOR TRADE ASSOCIATION'S OR SMALL BUSINESS GROUPS TO UTILIZE THEM. FOR EXAMPLE ONE STATE'S TRADE ASSOCIATION CAPTIVE MUST HAVE AN ANNUAL PREMIUM OF OVER $1 MILLION; IT IS SUBJECT TO APPROVAL OF ITS RATES; IT MUST ESTABLISH THAT THE INSURANCE IT PROVIDES IS OTHER-

WISE UNAFFORDABLE OR UNAVAILABLE--PRICE COMPETITION IS NOT SUFFICIENT JUSTIFICATION; IT MUST BE LOCATED IN THE STATE; AND IT WOULD STILL BE SUBJECT TO THE REGULATORY BARRIERS IMPOSED BY OTHER STATES FOR RISKS SITUATED IN THOSE STATES.....FEDERAL ACTION IS NECESSARY BECAUSE EXPERIENCE HAS SHOWN THAT INDIVIDUAL STATE LEGISLATION CANNOT FACILITATE THE FORMATION OF SELF-INSURANCE GROUPS. INDIVIDUAL STATES CAN ONLY ENACT LEGISLATION AFFECTING THEIR RESPECTIVE INSURANCE LAW REQUIREMENTS. THE PRACTICAL EFFECT OF THESE LAWS IS TO PREVENT PRODUCT SELLERS LOCATED IN SEVERAL STATES FROM FORMING SUCH GROUPS"

RECOGNIZING THIS PROBLEM, SEVERAL YEARS AGO CONGRESS PASSED THE RISK RETENTION ACT WHICH FACILITATED CAPTIVE FORMATION FOR PRODUCT LIABILITY RISKS. RECENTLY, A SIMILAR AMENDMENT WAS INCLUDED IN THE SUPERFUND REAUTHORIZATION ACT PASSED BY THE SENATE. THE AMENDMENT, WOULD FACILITATE CAPTIVE FORMATION TO INSURE POLLUTION LIABILITY RISKS WHICH THE INSURANCE INDUSTRY HAS EXCLUDED FROM COVERAGE IN ITS CGL POLICY. RIMS SUGGESTS THAT SUCH LEGISLATION SHOULD BE IMPLEMENTED ON AN ACROSS-THE-BOARD BASIS AND NOT JUST FOR POLLUTION AND PRODUCT LIABILITY. WE SINCERELY BELIEVE THAT CAPTIVE FORMATION CAN BE FACILITATED WITHOUT ABRIDGING LEGITIMATE STATE REGULATORY AUTHORITY.

TAX EQUITY SHOULD BE AFFORDED ALTERNATIVE-RISK FINANCING MECHANISMS

A SELF INSURED USING A LOSS RESERVE OR CAPTIVE-RISK FINANCING MECHANISM OPERATES IN A VERY SIMILAR FASHION TO A PROPERTY-CASUALTY INSURER. BOTH EMPLOY ACTUARIES OR QUALIFIED LOSS RESERVE SPECIALISTS

WHO DETERMINE HOW MUCH REVENUE NEEDS TO BE SET ASIDE TO FUND FUTURE LOSSES. THE TAX CODE PERMITS THE INSURER TO DEDUCT THE AMOUNT WHICH IT SETS ASIDE IN A LOSS RESERVE TO PAY FUTURE LOSSES. THAT SAME PRIVILEGE IS NOT EXTENDED TO THE SELF-INSURED WHO MUST OFTEN PURCHASE COMMERCIAL INSURANCE AT A MUCH GREATER EXPENSE IN ORDER TO RECEIVE THE SAME TAX TREATMENT AFFORDED TO THE INSURER UNDER THE TAX CODE. THIS SUBCOMMITTEE RECOGNIZES THE IMPORTANCE OF ENCOURAGING A STABLE FINANCING MECHANISM THROUGH WHICH AN ENTITY CAN PROTECT ITSELF AGAINST FUTURE LOSS AND THROUGH WHICH CLAIMANTS CAN RECEIVE JUST COMPENSATION. YET UNDER OUR PRESENT SYSTEM OF TAXATION, THE EMPHASIS IS PLACED ON WHETHER INSURANCE IS PURCHASED RATHER THAN THE QUALITY OF THE FUNDING MECHANISM.

IN THE 98TH CONGRESS, REPRESENTATIVE WILLIAM FRENZEL INTRODUCED H.R. 2642 WHICH WOULD PERMIT A DEDUCTION FOR CONTRIBUTIONS MADE TO CERTAIN SELF-INSURANCE LOSS RESERVES AND CAPTIVE PREMIUM PAYMENTS. AGAIN IN THE INTERESTS OF TIME, I AM ENCLOSING A COPY OF TESTIMONY WHICH RIMS SUBMITTED TO THE SUBCOMMITTEE ON OVERSIGHT OF THE HOUSE WAYS AND MEANS COMMITTEE ON THIS LEGISLATION. H R. 2642 IS EVEN MORE IMPORTANT AND TIMELY IN THE PRESENT CRISIS, AND WE HOPE TO SEE THE LEGISLATION REINTRODUCED IN THE NEAR FUTURE. THE PASSAGE OF THIS BILL WOULD PROVIDE THE CORPORATE INSURED THE DESPERATELY NEEDED FLEXIBILITY TO SURVIVE IN THIS ERA OF INSURANCE UNAVAILABILITY.

ON BEHALF OF THE RIMS MEMBERSHIP AND HALLMARK, I THANK YOU FOR YOUR KIND ATTENTION AND THE OPPORTUNITY TO SHARE OUR VIEWS. IF YOU HAVE ANY QUESTIONS, PLEASE ASK. THANK YOU.

Risk and Insurance Management Society, Inc.

December 4, 1985

Letter sent by RIMS to all state insurance commissioners urging their rejection of the claims made Commercial General Liability (CGL) Policy form of the Insurance Services Office.

Dear Commissioner.

Being reluctant to analyze ISO's CGL modification from information contained in a press release, RIMS withheld official comment on ISO's latest modifications until we received the actual policy language on November 18, 1985. The modifications made by ISO, while salutory, do not justify the use of its proposed claims made form to provide CGL coverage.

ISO has provided some much needed restrictions on what was the carrier's unilateral right to move the existing claims made policy's retroactive date forward upon renewal and thus obviate the insurer's obligation to indemnify. It should be noted that these restrictions may be advisory only as they are not contained in the claims made policy. Carriers may not be bound by these ISO guidelines. Please consider also that under ISO's guidelines a new carrier can still advance a policyholder's retroactive date. As long as this is possible the old carrier has tremendous leverage over its insured, knowing that a prudent policyholder who desires permanent tail coverage will have to pay the insurer up to 200% of its annual premium as a "severance fee". If ISO had wanted to address the problem of "insurer lock in", and not restrict the policyholder's ability to switch carriers in a free market, it would have restricted the new carrier's ability to advance the retroactive date for a new insured. It should also be pointed out that ISO permits the advancement of the retroactive dateupon agreement of the insured. The insured may agree to have the retroactive date advanced, lured by lower renewal premiums. What safeguards exist to make the less sophisticated insured aware of what he or she is giving up by advancing the retroactive date?

In the revised form ISO adds an additional automatic five-year extended reporting period for claims arising from occurrences within the policy period that are

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known before the end of the 60-day tail. As regulators, you should be aware that commercial insureds are often faced with claims arising out of occurrences taking place within the policy year that will be filed well after the 60-day tail. I'm not referring to the long-tail latent injury exposures; the majority of such late filed claims are your garden variety "slip and fall cases" that the insured was not aware of until the suit was brought. Without knowledge of the occurrence the insured cannot give notice; without notice the five-year tail is not activated and no coverage will be provided if a carrier (new or old) has advanced the retroactive date.

Second, many suits, for a variety of reasons, are not brought within five years of the policy year's end. The injury giving rise to the claim may not manifest itself for many years. The injured party may be a minor, who under the laws of most states has many years to initiate a claim. In these and many other situations, the five-year tail is of inadequate duration for an insured with a known loss exposure who is subject to a new retroactive date.

Third, ISO has still not adequately defined what is an occurrence, and yet it predicates the claims made policy's five-year tail on notifying the carrier of occurrences from which claims can stem. The insured, wanting to secure coverage, may inundate the carrier with a large number of files and documents, all containing what it hopes are potential "occurrences". Lawsuits will no doubt ensue as to what constitutes proper notification. More importantly, consider the litigation that will result because "occurrence" has not been adequately defined.

Suppose a computer manufacturer sells video display terminals (VDTs) which are used in offices around the country. A secretary of one of the manufacturer's customers files suit against the manufacturer alleging that 10 years of sitting in front of the manufacturer's VDT has given her chronic migraines. The policyholder promptly notifies the carrier of the claim, expecting to be covered during the five-year tail period for all migraine

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claims attributable to the use of its VDTs; this may not, however, be the case. For the automatic five-year tail, to apply, the injury from which the claims stem must have occurred "before the end of the policy period but not before any applicable retroactive date" (see Section V 2. c. and Section 1. 1.e). Under this claims made form neither the insurer nor the policyholder knows whether future migraine claims that come in will have resulted from injuries that have occurred during the policy year but not before the retroactive date. If the courts determine that the injury occurred during prolonged exposure, what if part of the exposure was before the policy's retroactive date and part of it after? Is coverage triggered? Perhaps the courts will delineate the trigger as when the symptoms manifest themselves and/or when the condition is formally diagnosed. If diagnosis or manifestation occurred after the policy year, is coverage triggered? If so, numerous polcies could be called upon to respond despite ISO's attempted non-stacking provision. Why? Because each claim will likely be treated by the courts as a distinct occurrence, although they are attributable to the same cause. It is most ironic that ISO and the insurance carriers complain bitterly of their treatment at the hands of the courts, and then offer as a policy trigger language that is literally a license to litigate - not only with the policyholder, but among themselves.

Where does all this uncertainty leave the policyholder? The carrier, aware of the large losses that could emenate from such VDT claims, may want to cut its losses and run. Any new carrier that the policyholder will seek is not interested in underwriting known loss exposures and will demand to advance the insured's retroactive date or obtain an exclusion of all VDT claims as a condition of coverage. What coverage has the policyholder triggered with its notification to the carrier? The insured has no way of knowing if migraine claims will be submitted within five years. The insured does not know what event the courts will deem to have triggered coverage or whether the trigger will have occurred before the policy's retroactive date or after the policy term, thus negating coverage.

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Faced with this uncertainty the prudent buyer will wish to purchase permanent tail coverage. Yet the policyholder is placed in a most inferior bargaining position. The insured is negotiating with an underwriter. who, not anxious to provide coverage for a known loss exposure. will undoubtedly wish to charge the maxiumum 200% premium allowed since that insured is going with another carrier. As existing claims are often not settled until well after the policy year, the insured has no idea of what portion of the aggregate limit has been exhausted, and therefore, what he or she is purchasing. When one considers ISO's stated intention to file for the inclusion of defense costs in the aggregate limit. the uncertainty becomes truly frightening.

ISO's modifications do not effectively minimize the inequity and uncertainty faced by the buyer purchasing permanent extended tail coverage at up to 200% of annual premium. ISO intends to distribute advisory tail factors that will take into consideration the amount of limits already exhausted (are they paid or reserved amounts?) in pricing the tail coverage. As indicated earlier, neither the insurer nor the policyholder will likely know what aggregate remains on the policy until well after the deadline for purchasing tail coverage has passed.

ISO also offers an optional endorsement for reinstatement of policy aggregates in the "tail" for claims arising out of occurrences unknown and unreported when the endorsement takes effect. The inadequacy of this approach is evident. First, the endorsement is optional w .h no assurance that it will be offered. Second, the applicability of these limits are subject to the vagaries of the occurrence trigger cited earlier. Third, as in the hypothetical case of the computer manufacturer, it will not be available to the insured who gives ts carrier notification of an occurrence - precisely the same insured who needs reinstatement the most.

These are but a few of the problems that a brief analysis of ISO's proposed claims made form indicates will

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be faced by the buyers of insurance. As regulators, you should consider the buyers of goods and services who rely on certificates of insurance from their vendors as proof of financial responsibility. Of what value will a certificate of insurance for claims made coverage be to the construction contractor who requires it from its subcontractors, to the homeowner who requires it from the company fixing his or her septic tank, or to the political subdivision or municipality within your state, which demands a certificate of insurance from the numerous vendors it does business with? The switch from an occurrence limit to an overall aggregate limit already compromises the value of certificates of insurance. However, a certificate of insurance for claims made coverage may not be worth the paper its written on. Why? Unless the insured perpetually renews coverage with the same carrier, purchases permanent tail coverage, or has a claim submitted against it within the policy year, there is no assurance of indemnification by the carrier. Similarly, under such circumstances the proposed claims made CGL guts the protection afforded to the general public when state law mandates insurance coverage as a condition of engaging in certain activities (i.e. asbestos removal, hazardous waste disposal, etc.).

Despite all of these problems for the policyholder and general public, which are inherent in the proposed claims made format, ISO has, in effect, asked the regulatory community to end the debate, approve the form by ISO's self imposed January 1, 1986 deadline, and deal with the consequences later. Worse still, before all of the consequences of the claims made CGL become known, ISO will be proposing in the near future a defense cost inclusion that will exacerbate the regulator's problems.

From a regulator's perspective, does this make any sense? A recent article in Business Insurance indicates that few insurers in the carrier community are ready to implement the claims made CGL anywhere near the January 1 deadline. Why are you being asked to act in haste

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and repent at leisure? As defense costs are an integral element of the CGL, why is ISO seeking to have it approved in the future as a separate issue? There is no valid reason why ISO's modified occurrence policy, with fixed aggregate limits and an anti-stacking provision, will not respond to the carriers' stated concerns. Indeed, this was the premise behind the New York Insurance Department's rejection of the claims made forms in favor of ISO's occurrence filing. RIMS recognizes that because of the imprecise definition of "occurrence" in both the claims made and occurrence policy formats, this may be an interim solution. However, it is a far wiser regulatory alternative to go with ISO's modified occurrence format as an interim solution than to follow ISO's lemming-like march into the claims made abyss of coverage gaps, increased litigation, and insurer lock in.

In reaching a long-term solution to the elusive problem of defining occurrence, RIMS proposes the formation of a blue ribbon panel composed of regulators, carriers, consumers, producers, reinsurers, the judiciary, and members of the legal profession. The task is a multifaceted one that requires a pooling of all of our intellectual resources and experiences. The resulting solution to these problems must protect all interests, any solution that serves the interest only of one group, such as the ISO claims made CGL form, will only make existing problems worse.

Sincerely,

Jon Harkavy
Director
Governmental Affairs

JP/lt

January 22, 1986

STATEMENT OF

THE RISK AND INSURANCE MANAGEMENT SOCIETY, INC. (RIMS)

ON

ISO'S JANUARY 14, 1986 MODIFICATIONS TO ITS CGL CLAIMS-MADE FORM

On January 16, 1986, ISO announced further modifications to its claims-made Commercial General Liability (CGL) Policy. Following review, the Risk and Insurance Management Society (RIMS) has determined that it will not now actively seek rejection of this form by state insurance regulators. This is not now to say the Society endorses, either expressly or by implication, this new form. Nor does it restrict RIMS Chapters or members from pursuing any course of action they may choose to take with their state insurance commissioners.

RIMS commends ISO for making these latest necessary changes to the claims-made CGL form. RIMS thanks its supporters, in the state regulatory community -- Commissioner John Washburn of Illinois, Superintendent James Corcoran of New York, and Commissioner Peter Gillies of Connecticut, in particular -- whose courageous efforts in reforming ISO's earlier proposals have led to a more equitable claims-made CGL form,

RIMS regrets the strategy employed by the insurers seeking acceptance of the claims-made form. The industry introduced a totally unacceptable and one sided product, making as few piecemeal changes as it felt it could get away with in order to win the approval of state insurance departments. RIMS would have preferred that a more equitable CGL claims-made policy form would have been introduced by the insurance industry at the outset, although ISO's initial offering served to strengthen the solidarity of RIMS members and indeed all commercial insurance policyholders against the proposed form.

RIMS CONTINUED CONCERNS OVER CLAIMS-MADE CGL

ISO President Daniel J, Mc Namara, in a press release dated January 17, 1986 states that, "These new provisions eliminate any rational reservations about the claims-made form," RIMS strongly disagrees, and trusts that insurers, brokers and agents do not take such a cavalier attitude in selling claims-

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made liability coverage to unsuspecting policyholders. All risk managers should have strong reservations about the claims-made form and take appropriate measures to protect their employer's interest.

Unlike occurrence coverage, "claims-made" will not respond to claims resulting from an event unknown or unreported to the insured, 60 days after the policy's expiration date. Unless the initial claims-made policy's retroactive date remains the same, subsequent policies may not provide coverage for such claims. ISO's newly dubbed "supplemental tail" does provide coverage against such an exposure, but at a potentially exorbitant price of up to 200% of the expiring annual premium.

RIMS hopes that this potential 200% "severance fee" will not hang over the policyholder's head, like the Sword of Damocles, should a cancellation or non-renewal take place. RIMS encourages ISO and the insurer community to devise a mechanism to price supplemental tail coverage prior to the policy's inception. Such a mechanism is in the insurer's interest as well as the policyholder's, for without it, the insurer will undoubtedly be subject to more stringent regulations on cancellation or non-renewal, and potential judicial determinations that such cancellation or non-renewal is in bad faith.

COVERAGE TRIGGER

RIMS wished that ISO had directed its energies toward resolving the vagaries of the occurrence form's coverage trigger rather than attempting to gloss over this problem by reducing limits and the scope and continuity of coverage. RIMS fears that many of the same problems which previously led to intra-insurer and policyholder-insurer coverage disputes may well continue with the new form. A far more responsive approach has been taken by St. Paul in its soon to be filed CGL form. The "incident first reported" approach adopted by St. Paul will, RIMS believes, result in less litigation as to the coverage trigger.

CONTINUED EXISTENCE OF OCCURRENCE COVERAGE

It is with considerable skepticism that RIMS accepts ISO's repeated assertions that its claims-made form will not drive its occurrence form from the market. We hope that ISO's dual format offering is not a cynical gesture designed to give the buyer an illusory freedom of choice.

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RIMS strongly considered, but ultimately rejected, proposing that both claims-made and occurrence coverage be offered simultaneously to the insured. Such a requirement may be too intrusive a restriction on a marketplace that needs flexibility to survive the present capacity crunch. However, RIMS still believes that the occurrence form is the proper vehicle for the transfer of risk for the majority of the insurance buying public. Over the long term RIMS will hold both ISO and insurers to their promise of continued viability of the occurrence form. Without such freedom of choice in the marketplace, insurers will see their new claims-made form gutted by the courts in a manner similar to the recent Sparks v St. Paul decision. They may also find the anti-trust immunity afforded them under the McCarran Ferguson Act eroded by rulings such as St. Paul v Barry in which the Supreme Court of the United States determined that the defendant had engaged in an illegal boycott by forcing the policyholder to accept "claims-made."

INSURANCE AVAILABILITY

In view of current market conditions RIMS reluctantly concludes that ISO is correct in its belief that liability coverage may not be written at all for certain insureds except on a claims-made form. While this could be construed as a self fulfilling prophecy on the part of insurers, RIMS has understandably determined that a more reasonable claims made coverage is better than no coverage at all. Without viewing ISO's proposed claims-made CGL as a panacea for the insurance availability crisis, RIMS hopes that those who clamored for the necessity of the claims-made form, will now make available needed capacity, and work toward restoring sanity to the insurance marketplace.

POLLUTION COVERAGE

As state regulators consider the ISO claims-made CGL policy, RIMS must again raise the issue of the total pollution exclusion. While in total agreement with insurers that "gradual" pollution cannot and should not be included in the CGL form, under ISO's total exclusionary approach, coverage no longer exists for unique and unusual "sudden and accidental" incidents. For the 95 percent of U.S. policyholders whose environmental impairment liability exposure is slight, coverage will be denied for the rare incident that could lead to bankruptcy - precisely the reason for the purchase of insurance.

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"Sudden and accidental" coverage is needed protection which can be handled under the CGL mechanism. Yet ISO chose the easy way out and lumped it together with "gradual" pollution coverage. RIMS submits that "sudden and accidental" can be defined so as to distinguish it from "gradual" pollution coverage. Instead, ISO threw in the towel and said, we can't define "sudden and accidental" so we will not offer any pollution coverage at all.

In defending its total pollution exclusion ISO maintains that the courts will misinterpret any "sudden and accidental" coverage to provide gradual pollution coverage. RIMS disagrees. As the Environmental Protection Agency pointed out in its solicitation for comments on the lack of Environmental Impairment Liability insurance, there is no demonstrated proclivity of the courts to misinterpret "sudden and accidental" pollution coverage, and that any such judicial decisions are more likely the result of poor policy drafting. A more responsible approach, RIMS believes, is not a total pollution exclusion but, policy language to delineate "sudden and accidental" from "gradual" pollution. Attached is a "sudden and accidental" pollution endorsement presently on the market which does just that. RIMS believes the burden is on ISO to explain why such coverage can not be included within its CGL policy form, or why it will not draft such coverage provisions.

DEFENSE COSTS WITHIN LIMITS

Despite ISO's attempts to sell the claims-made CGL form as an improved, modernized, simplified, and consumer oriented policy, a realistic assessment of the form indicates otherwise. It provides what the New York Insurance Department correctly describes as "generally inferior coverage." It offers lower limits, more restrictive and less continuous coverage than is provided under ISO's present occurrence CGL form. Insurers have won significant concessions in the new CGL which will be borne by insurance consumers and which may ultimately impact society as a whole. In recognition of the reduced coverage afforded by "claims-made", RIMS believes that ISO's attempts to obtain any percentage of defense costs within limits in the near future is totally unjustified and an affront to policyholders and the regulatory community. RIMS urges ISO to withdraw this proposal entirely and not to pursue a strategy through which we have a multi-state auction to discover what percentage of defense cost limits the regulatory community will accept. The prestige of ISO will decline as a result, and judging by the current reaction of commissioners, agents, brokers and buyers, no one is bidding in this defense within limits auction.

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CONCLUSION

RIMS salutes ISO for its able advocacy on behalf of its insurance company members. However, ISO's job, and the responsibilities of insurers has just begun. As a representative of the policyholder RIMS will wait to see whether the claims-made form will improve insurance availability and provide the reliable and continuous coverage promised. RIMS will work with ISO to educate RIMS members in a manner that will hopefully facilitate responsible implementation of the claims-made form.

RIMS, however, will also be working to encourage the development of alternative risk financing mechanisms which will serve the needs of businesses, local governments, and institutions deserted by the insurance marketplace. Equally as essential, RIMS will work to enact reforms in our civil justice system that will allow insurers to insure, governments to govern, professionals to practice, businesses to operate and develop, legitimate claimants to be compensated, and, most importantly, society to function. In this vital task, the insurance industry will have the complete and total support of the Risk and Insurance Management Society.

ONSHORE SEEPAGE POLLUTION AND CONTAMINATION EXCLUSION

Except as hereinafter specified in this clause, this policy provides no coverage for bodily injury or property damage arising out of the discharge, dispersal, release, or escape of smoke, vapors, soot, fumes, alkalis, toxic chemicals, liquids or gases, waste materials, oil or other petroleum substance or derivative (including any oil refuse or oil mixed with wastes) or other irritants, contaminants or pollutants into or upon land, the atmosphere or any watercourse or body of water. This exclusion shall not apply as respects liability for an occurrence causing discharge, dispersal, release or escape provided the insured establishes that all of the following conditions have been met.

a) the occurrence commenced during the time of this policy,

b) the occurrence was accidential and was neither expected nor intended by the insured,

c) the occurrence was identified as commencing at a specific point in time and became known to the insured within 40 hours thereafter.

d) the occurrence did not result from the insured's intentional and willfull violation of any governmental statute, rule or regulation.

INTEGRATION OF FINANCIAL SERVICES

SUBMITTED BY

JON HARKAVY, DIRECTOR OF GOVERNMENTAL AFFAIRS

ON BEHALF OF

THE RISK AND INSURANCE MANAGEMENT SOCIETY, INC.

TO

THE NEW YORK STATE TEMPORARY COMMISSION

ON BANKING, INSURANCE, AND FINANCIAL SERVICES

DECEMBER 1, 1983

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THIS TESTIMONY ON THE INTEGRATION OF FINANCIAL SERVICES IS BEING SUBMITTED AS PART OF THE PRINTED RECORD OF THE PUBLIC HEARING HELD ON DECEMBER 1, 1983 BEFORE THE NEW YORK STATE TEMPORARY COMMISSION ON BANKING, INSURANCE, AND FINANCIAL SERVICES BY THE RISK AND INSURANCE MANAGEMENT SOCIETY, INC. (RIMS). RIMS IS A NON-PROFIT ORGANIZATION REPRESENTING CORPORATE AND GOVERNMENTAL CONSUMERS OF INSURANCE WITH A MEMBERSHIP COMPRISED OF MORE THAN 3,800 CORPORATIONS, INSTITUTIONS, AND GOVERNMENTAL BODIES IN 77 CHAPTERS LOCATED THROUGHOUT THE UNITED STATES AND CANADA. THREE OF OUR CHAPTERS ARE LOCATED IN NEW YORK, REPRESENTING OVER 300 OF THE LARGER CORPORATIONS HEADQUARTERED IN THE STATE. IN ADDITION, MANY MORE OF OUR MEMBERS HAVE SIGNIFICANT OPERATIONS IN THE STATE AND PURCHASE SIGNIFICANT AMOUNTS OF INSURANCE FROM NEW YORK INSURERS. IN TERMS OF TOTAL PREMIUM DOLLAR OF INSURANCE PURCHASED, RIMS IS THE LARGEST ORGANIZATION OF INSURANCE CONSUMERS IN THE STATE AND THE COUNTRY.

THE PURPOSE OF THESE COMMENTS IS NOT TO ENDORSE OR OPPOSE ANY CURRENT LEGISLATION DEALING WITH FINANCIAL INTEGRATION, BUT RATHER TO OFFER MINIMUM REGULATORY CONSUMER CONCERNS WHICH THE SOCIETY BELIEVES MUST BE ADDRESSED IN ANY LEGISLATION DEALING WITH THE POSSIBLE INTEGRATION OF BANKING AND INSURANCE SERVICES. AS LARGE VOLUME PURCHASER OF INSURANCE, RIMS MEMBERS ARE KEENLY INTERESTED IN THE IMPACT THAT THE BREAKING DOWN OF TRADITIONAL BARRIERS SEPARATING THE BANKING AND INSURANCE INDUSTRIES WILL HAVE ON THE INSURANCE MARKET, INSURER SOLVENCY AND INSURANCE REGULATION.

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INTEGRATED FINANCIAL SERVICES IS OF COURSE, THE INDUSTRY WATCHWORD FOR ANY COMPANY OFFERING INSURANCE, INVESTMENTS, AND CREDIT TO THE PUBLIC. IT WOULD SEEM THAT THE SHORT TERM EFFECT TO RIMS MEMBERS FROM THE ENTRY OF BANKS INTO THE INSURANCE FIELD WOULD BE NEUTRAL. THE INTEREST OF BANKS AT THIS TIME SEEM TO FOCUS PRIMARILY ON PERSONAL RATHER THAN COMMERCIAL LINES OF INSURANCE. THIS INTEREST SEEMS TO BE EVEN MORE FOCUSED ON THE OPPORTUNITY TO DISTRIBUTE THE INSURANCE PRODUCT, RATHER THAN TO UNDERWRITE THE RISK ITSELF. NEVER THE LESS, FINANCIAL INTEGRATION OFFERS THE POSSIBILITY OF FUTURE BANK INVOLVEMENT IN THE COMMERCIAL INSURANCE MARKET, WHICH IN TURN MAY INCREASE COMPETITION AND LOWER THE PRICE OF THE INSURANCE PRODUCT. RIMS WELCOMES NEW ENTRANTS INTO THE INSURANCE MARKET PLACE IF, AND ONLY IF, PROPER REGULATORY STANDARDS CAN BE MAINTAINED.

OF PARTICULAR CONCERN TO THE SOCIETY ARE FOUR CRUCIAL AREAS:

1. THE CONTINUED REGULATION OF INSURANCE BY THE STATE INSURANCE DEPARTMENTS;
2. THE PREVENTION OF THE TIE IN ARRANGEMENTS BETWEEN THE ISSUANCE OF CREDIT AND THE SALE OF INSURANCE;
3. THE MAINTENANCE OF INSURER AND BANKING SOLVENCY; AND
4. THE PROTECTION OF MARKET COMPETITION

TWO REGULATORY EXTREMES MUST BE AVOIDED WITH THE EMERGENCE OF FINANCIALLY DIVERSIFIED INSTITUTIONS. THE FIRST IS THE CREATION OF A REGULATORY VOID WHERE NEITHER THE FEDERAL GOVERNMENT OR THE STATES HAVE THE AUTHORITY TO EXERCISE REGULATORY OVERSIGHT. THE OTHER EXTREME IS THE SITUATION WHERE DUAL AND OFTEN CONFLICTING REGULATORY AUTHORITY CAN BE IMPOSED ON THE DIVERSIFIED ENTITY BY THE FEDERAL AND STATE GOVERNMENTS.

IN TERMS OF BOTH THE QUALITY AND COST EFFICIENCY OF INSURANCE REGULATION, RIMS BELIEVES THAT THE INSURANCE CONSUMER WOULD BENEFIT IF BANKS ENTERING INTO THE INSURANCE FIELD BE REGULATED AS TO THEIR INSURANCE ACTIVITIES BY STATE INSURANCE DEPARTMENTS. THERE IS NO COMPARABLE BODY AT THE FEDERAL LEVEL WITH THE EXPERIENCE AND TECHNICAL SUPPORT TO PROVIDE THIS NEEDED REGULATION. WHILE THE SOCIETY IS CONCERNED THAT STATE REGULATORS MAY LACK THE RESOURCES TO PROVIDE ADEQUATE OVERSIGHT OF FINANCIALLY INTEGRATED INSTITUTIONS, THE PROBLEM OF FUNDING CAN BE MORE EASILY RECTIFIED THAN THE PROBLEMS INHERENT IN CREATING A NEW AGENCY ON THE FEDERAL LEVEL. IN SHORT, GIVEN THE IMPORTANCE TO THE CONSUMER OF A SOUND REGULATORY FRAMEWORK UPON WHICH THE INTEGRATED INSTITUTION WILL OPERATE, THE SOCIETY URGES THAT IF BANKS AND OTHER FINANCIAL INSTITUTIONS DO ENTER THE BUSINESS OF PROPERTY/CASUALTY INSURANCE, THAT THEY SHOULD BE REGULATED BY THE SAME INSURANCE DEPARTMENTS-AND SUBJECT TO THE SAME REGULATIONS AS INSURERS.

THE FINANCIAL SOLVENCY OF THE INSURER, BE IT A BANK, A TRADITIONAL INSURANCE COMPANY, OR OTHER ENTITY, IS OF KEY REGULATORY IMPORTANCE TO THE CONSUMER. TO STATE THE OBVIOUS, INSURANCE IS PURCHASED TO MINIMIZE RISK - A MARKETPLACE STREWN WITH INSOLVENT INSURERS, NO MATTER HOW COMPETITIVE, IS NO BARGAIN TO THE INSURANCE CONSUMER.

THE SAFETY NETS FOR INSOLVENCY, SUCH AS FEDERAL DEPOSIT INSURANCE FOR BANKS AND STATE GUARANTY FUNDS FOR INSURANCE, MUST BE CONSTRUCTED STRONG AND LARGE ENOUGH TO RESPOND TO THE INSOLVENCY OF A GIANT INTEGRATED SYSTEM-ADMITTEDLY NO EASY TASK. HOWEVER, THE SUCCESS OF THESE SAFETY NETS ARE RARELY DUE TO THE SIZE

OF THE RESERVES ALONE. IT IS THE QUALITY OF THE REGULAT RY EFFORT EXERCISED BY THE FEDERAL RESERVE BOARD AND THE STATE INSURANCE DEPARTMENTS TO PREVENT INSOLVENC. S WHICH IS THE TRUE PROTECTION OFFERED TO CONSUMERS IN THE EVENT OF A FINANCIAL INSTITUTION'S FAILURE.

SOUND REGULATION OF THE INTEGRATED ENTITY REQUIRES TIGHT RESTRICTIONS ON THE ABILITY TO COMMINGLE ASSESTS ASSOCIATED WITH INSURANCE AND BANKING ACTIVITIES. IN ANY DIVERSIFIED FIRM THERE IS THE VERY REAL DANGER OF DEBTS SPILLING OVER FROM ONE BUSINESS TO ANOTHER. IT IS ESSENTI L THAT THE POLICYHOLDER BE PROTECTED BY PREVENTING RESERVES SET ASIDE TO PAY CLAIMS FROM BEING RAIDED TO PAY CREDITORS. ONE PROPHYLACTIC MEASURE WHICH THE SOC Y URGES TO PREVENT SUCH . SITUATION, IS TO REQUIRE ANY ENTITY ENGAGED IN BOTH BANKING AND INSURANCE TO ..SULATE ONE ACTIVITY FROM ANOTHER THROUGH THE USE OF SEPARATE SUBSIDIARIES FOR EACH ACTIVITY WITH AN UPSTREAM HOLDING COMPANY.

SIMILARLY, FOR REASONS OF BOTH SOLVENCY PROTECTION AND MARKET COMPETITIVENESS, TRANSACTIONS BETWEEN INSURANCE AND BANKING AFFILIATES MUST BE REGULATED SO AS TO REQUIRE THAT SUCH TRANSACTIONS BE MADE ON SUBSTANTIALLY THE SAME TERMS AND CIRCUMSTANCES (INCLUDING CREDIT STANDARDS), AS THOSE PREVAILING AT THE TIME OF THE TRANSACTION BETWEEN THE BANK/INSURER AND A NON AFFILIATED COMPANY.

THE ATTRACTIVENESS OF FINANCIAL INTEGRATION TO THE INSURANCE CONSUMER IS THE EXPECTATION THAT ADDED COM ETITION WILL BRING GREATER EFFICIENCY TO THE MARKETPLACE. CONCERN HAS BEEN EXPRESSED THAT SMALL AND MIDDLE-SIZED FI . . INSTITUTIONS WILL BE CROWDED OUT OF THE MARKET OR SEEK SHELTER IN A LARGE

CONGLOMERATE. THE SOCIETY, WHOSE MEMBERS AS CONSUMERS HAVE THE MOST TO LOSE FROM SUCH DECREASED COMPETITION, BELIEVES THIS CONCERN IS NOT JUSTIFIED.

BOTH BANKING AND INSURANCE ARE DEMANDING SPECIALTIES WITH A CONSIDERABLE BODY OF TECHNICAL KNOWLEDGE AND BUSINESS ACUMEN. MERGERS MAY GET RID OF EXCESS CAPACITY AND MAKE THE INDUSTRIES MORE EFFICIENT AND SPECIALIZED. HOWEVER, HUGE SIZE AND FULL INTEGRATION WILL NOT BE NECESSARY FOR SURVIVAL. RECENT ENTRANTS INTO THE PROPERTY/CASUALTY INSURANCE BUSINESS, SUCH AS MAJOR LIFE INSURERS,HAVE DISCOVERED THEY ALMOST INVARIABLY OPERATE IN THE RED DURING THEIR EARLY YEARS IN BUSINESS. NOR HAS THE CROSS SELLING OF NEW PRODUCTS THROUGH AND EXISTING DISTRIBUTION BASE BEEN AN UNQUALIFIED SUCCESS. SALE OF INSURANCE THROUGH THE SEARS CATALOGUE HAS NOT BEEN VERY SUCCESSFUL, NOR HAS THE SALE OF FIREMEN'S FUND INSURANCE THROUGH AMERICAN EXPRESS. THE SOCIETY BELIEVES THAT THE KEY TO SUCCESS IN THE INSURANCE FIELD IS THE ABILITY TO IDENTIFY WITH AND TAILOR PRODUCTS TO A CUSTOMER'S NEEDS. WHILE A FINANCIAL CONGLOMERATE MAY HAVE CERTAIN ADVANTAGES OF SIZE OR DISTRIBUTION BASE, THE SMALLER, SPECIALIZED INSURANCE COMPANY OR AGENCY HAS THE ABILITY TO ADOPT TO CHANGING CONSUMER PRACTICES AND PREFERENCES IN A WAY THAT A LARGE FINANCIAL CONGLOMERATE NEVER COULD.

A REGULATORY CONCERN WHICH MUST BE ADDRESSED, HOWEVER, IS THE CAPACITY OF BANKS TO CONTROL THE DECISIONS OF MANY BORROWERS AS TO THE SOURCE OF INSURANCE THAT THEY PURCHASE IN CONJUNCTION WITH EXTENSIONS OF CREDIT. SUCH A DANGER

IS MOST PRONOUNCED F HE PERSONAL LINES AND SMALL COMMERCIAL INSURED, WHERE THE GREATER D RITY IN BARGAINING POWER BETWEEN THE LOAN APPLICANT AND BANK MAY MAKE EBTOR MORE SUSCEPTIBLE TO THE LOAN OFFICER'S SUGGESTIONS CONCER . CHOICE OF INSURER. THE SOCIETY URGES THAT ANY OVERT TIE IN BETW THE ISSUANCE OF CREDIT AND THE PURCHASE OF INSURANCE REMAIN STRICTLY F IBITED. EVERY LOAN APPLICANT SHOULD BE ADVISED IN WRITING BY THE P NTIAL LENDER/INSURER THAT SUCH CREDIT TIE-IN IS ILLEGAL. FURTHERMORE, THE DIVIDUAL CONSUMER MUST BE GIVEN AN ADMINISTRATIVE OR JUDICIAL REMEDY PURSUE IF HE OR SHE BELIEVES THAT THEY HAVE BEEN DENIED CREDIT BECAUSE THEIR REFUSAL TO PURCHASE INSURANCE FROM THE LENDER. IT IS THE SOCIETY'S FIRM CONVICTION THAT AN INFORMED CONSUMER, GIVEN THE ABILITY TO SEEK REDRESS, WILL CURB ANY POTENTIAL ABUSES WHICH MAY OCCUR.

IN CONCLUSION, THE TREND TOWARD FINANCIAL INTEGRATION PRESENTS A CHALLENGE TO BUYER, SELLER AND REGULATOR ALIKE. TO THE CONSUMER MORE OPTIONS WILL BE AVAILABLE, BUT THERE WILL BE A CORRESPONDING RESPONSIBILITY TO DISCERN THE BEST PRODUCT FOR HIS OR HER PURPOSE AMONG A MYRIAD OF COMPETING SERVICES. SELLERS WILL HAVE TO COMPETE IN A MORE COMPETITIVE MARKETPLACE. AND PERHAPS THE GREATEST CHALLENGE IS FOR THE REGULATOR, WHO WILL HAVE TO EVOLVE AT THE PACE AND IN THE DIRECTIONS DICTATED BY THE DEMANDS OF THIS COMPETITIVE MARKET-PLACE.

TESTIMONY OF THE RISK AND INSURANCE MANAGEMENT SOCIETY, INC. BEFORE THE SUBCOMMITTEE ON OVERSIGHT OF THE HOUSE WAYS AND MEANS COMMITTEE ON TIMING AND MEASUREMENT OF TAX DEDUCTIONS

This statement submitted for inclusion in the printed record of the Friday February 24, 1984 United States House of Representatives Subcommittee on Oversight of the Ways and Means Committee's hearing on the Timing and Measurement of Tax Deductions is submitted on behalf of the Risk and Insurance Management Society, Inc., commonly known as RIMS. RIMS is a nonprofit organization representing corporate and governmental self insurers and consumers of insurance in 77 chapters located throughout the United States and Canada. Corporate members include 90% of the top Fortune 1,000 list.

At this point one might ask: "What is risk management?"; "Who are risk managers?"; "Why are they so interested in the timing and measurements of tax deductions?". Starting with the last question, it cannot be overemphasized that the "timing and measurement of tax deductions" is not merely an accounting issue as implied by Secretary Regan in his February 1, 1984 Budget Briefing, but rather an issue which impacts deeply on the freedom of a corporation to reduce costs by developing a stable self-insured funding mechanism to deal with predictable future losses. To restrict the ability of the self-insured corporation to deduct funds allocated on an accurate basis to pay these predictable losses would be to mandate inefficiency as a tax-policy goal and to ratify the tax inequity which already exists between the self-insured and commercial buyers of insurance. It would be in the best interests of the Treasury, the business community and potential claimants if Congress would direct its efforts

toward equalizing the tax treatment of commercial purchasers of insurance and self insureds.

The following brief explanation of the risk management process will bring this issue into sharper focus. In the not too distant past, most corporations handled their business risks by relegating the purchase of insurance to a clerk. The clerk shopped around until he or she found what was hoped to be the right coverage at the most competitive price. Occasionally, a company purchased too much or too little insurance, but, in general, the corporation was adequately protected.

Unfortunately, as business risks escalated, it became more difficult to buy insurance to cover these exposures. Premiums for standard coverages have risen astronomically, and many insurance companies simply refuse to cover high-risk operations. It has been under these circumstances of growing corporate and governmental liability exposure that the field of risk management has evolved.

Risk management is the process of planning, organizing, directing and controlling the resources and activities of an organization to cost-effectively minimize the adverse effects of accidental losses on that organization. In the last 10 years, risk management has evolved from infancy to maturity, and many top corporations now give high priority to risk management programs.

As the role of risk management and its practicioners has grown, so has the status of the risk manager; from a clerk relegated to the purchase

of insurance to an expert on risk identification, risk measurement and evaluation, risk elimination or reduction, and risk finance. Obviously, not all risk can be eliminated, and it is the risk manager's task to devise the most economically efficient means to deal with an organization's risk of loss. It is this process, risk finance, which is rapidly changing the insurance industry.

Today, an increasing number of corporations are financing a major portion of their losses internally, particularly when such losses are relatively frequent and predictable. "First dollar" insurance purchases in which coverage is obtained for the full extent of the loss, is becoming rarer. A brief example explains why.

A supermarket chain might find that its loss history over a 10-year period for "slip and fall" tort liability claims is relatively consistent, approximately $500,000 a year. The corporation could purchase "first dollar" insurance coverage which would cover the corporation for the full extent of its losses. However, this approach involves an expenditure by the corporation in the form of an insurance premium which exceeds the anticipated $500,000 loss, because the premium reflects not only the anticipated $500,000 in losses it intends to pay out, but profit and overhead as well. It is in this situation that the field of risk management comes into play to determine what type and percentage of risk that should be assumed internally and, similarly, to determine the type and percentage of risk that would be more economically efficient to handle through the purchase of commercial insurance.

One such technique is to establish a reserve for expected losses. This method acknowledges the existence of risk and creates a reserve on the balance sheet. The IRS has recognized this technique in Code Section 537(b)(4), which allows the accumulation of reasonable product liability loss reserves, without subjecting the reserve to a tax on unreasonable accumulation of earnings. It should also be emphasized that the practice of maintaining a reserve plan is not only recognized but, in essence, mandated by the Financial Accounting Standards Board (FASB) in its FASB Standard Number 5 (FASB-5). FASB-5 states that highly predictable future payments arising from events that have occurred, including self-insured losses, are to be charged to income in the current period. This directive reflects FASB's concern that predictable losses should be reflected on the corporate balance sheet.

Under present law, the reserves set aside in the aforementioned supermarket example would not be deductible. It is only under the most limited circumstances that a taxpayer can receive a deduction for reserves set aside for self-insurance. As a practical matter, the landmark case in the area, Kaiser Steel v. United States of America, 82-2USTC9635 (N.D. Cal 1982) permits the corporate taxpayer a deduction only for amounts allocated to a self-insured workers' compensation reserve. In this case, the Court stressed that all of the events that bear on the fact of liability must have occurred in the tax year in which the taxpayer is claiming the deduction. The taxpayer in Kaiser was able to meet this test because workers' compensation is essentially a no-fault system in which liability is attached to the employer whenever an injury occurs in the work place. Under very few circumstances other than workers'

compensation, could the taxpayer claim a deduction. Moreover, the Court in Kaiser insisted that the amount of the liability must be determined with reasonable accuracy before the deduction could be taken. The taxpayer in Kaiser utilized the services of an experienced loss reserve specialist (much like an insurance company would in establishing the level of its own loss reserves) to determine what amounts would be required to meet its workers' compensation obligations in that year. This accuracy was not lost on the Court which noted . . . "We see that the amount of liability reserved proved to be accurate within 7% . . . and that to produce that modest inaccuracy Kaiser Steel under-reserved rather than over-reserved." Thus, in order to qualify for the deduction in Kaiser, the taxpayer had to prove that the amount set aside in the workers' compensation reserve reflected a sound computation and was not a number "pulled out of a hat".

Yet, it seems that the Administration proposes to legislatively take away the deduction permitted to the taxpayer in the legally sound Kaiser decision as a so-called "accounting abuse". RIMS most respectfully disagrees that the deduction allowable under Kaiser constitutes any kind of accounting abuse. As pointed out earlier, the taxpayer in Kaiser actually took less of a deduction than it was entitled to in that tax year. Furthermore, the Court made it clear that a taxpayer could not arbitrarily over-reserve in a workers' compensation loss reserve fund in hopes of obtaining a tax deduction. The amount set aside in such a workers' compensation fund must be determined with reasonable accuracy before the deduction can be taken. To arrive at such a reasonable estimate, it is virtually mandatory that the services of either a qualified

actuary or loss reserve specialist be utilized by the employer in calculating its projected workers' compensation obligations in that year. That process is, in essence, no different than the one employed by traditional insurers in projecting their own loss reserves. And, as should be pointed out, amounts placed in an insurer's loss reserves are not taxable under the Internal Revenue Code.

Even if no such accounting abuse occurs, many on the Subcommittee may be considering this proposal in terms of its revenue enhancement potential. If that is indeed the case, then RIMS most respectfully submits that those members will be greatly disappointed. Kaiser applies to only the relatively few taxpayers who are eligible and do reserve their own workers' compensation fund. At best, the Treasury will get a one-shot acceleration of revenue flow as the timing of deductions claimed by self-insured corporations is postponed to coincide with actual payment or accrual of losses.

The cost to our economy, on the other hand, is a permanent loss of efficiency, because corporations will not be able to freely choose whether to self-insure or to procure commercial insurance based on economic considerations. Nullifying the deduction in the Kaiser case will create a situation where an employer who utilizes a traditional insurance carrier to provide workers' compensation coverage will receive a deduction while a self insurer will not. Many self-insured employers who desire such a tax deduction may indeed switch, either totally or partially, to a commercial insurer. Logically, it may be more costly and less efficient for the employer to obtain coverage through a commercial insurer than it

would be for that same employer to self insure. The employer's deduction for obtaining workers' compensation coverage from a commercial insurer is very likely to exceed that same deduction it was permitted to deduct as a self insurer. Large companies, which can and now do efficiently self-insure, will have a tax-motivated reason to behave inefficiently. This result makes a mockery of Treasury's claim that revenue enhancement should be based on tax equity. What could be further from equity than to subsidize inefficient and high-cost commercial insurance by disallowing deductions for all competing self-insurance funds?

Rather than further exacerbating the existing inequity towards self insurers in the Internal Revenue Code, RIMS urges this Subcommittee to consider reforming the Tax Code to permit taxpayers who elect to self insure certain types of risks in addition to workers' compensation claims, the same tax treatment with respect to self-insured reserves, as if they had opted to purchase commercial insurance.

Congress, in permitting a deduction for insurance premium purchases, recognizes that protecting an entity from accidental loss is essential to sound economic planning. Congress, similarly, recognizes the importance of encouraging a stable funding mechanism through which claimants can receive just compensation. Yet, under our present system of taxation, the emphasis is placed on whether insurance is purchased or the risk transferred, rather than on the quality of the funding mechanism.

There are many sound policy reasons for amending the Code to permit a deduction for self-insurance reserving practices. From product liability

to toxic waste, Congress and the courts have been enlarging the scope of corporate responsibility in almost every area. This has not been without ramifications. The greater the liability exposure, the higher the cost of securing commercial insurance coverage, if such coverage is available at all. These higher insurance costs are passed on to the ultimate consumer of the insured corporation's products and services. Moreover, the development of new products and services can be hindered because of excessive costs of insurance coverages for new risk exposures created by technological advances. Similarly, corporate funds are being devoted to securing insurance coverage at the expense of much needed capital investment. This, in turn, has a detrimental impact on the competitiveness of American industry.

Given the demands of the courts and Congress, a viable mechanism for self insurance is essential to deal with these enlarged loss exposures. A qualified self-insurance program permits the corporation to lower insurance costs which would otherwise be passed on to consumers. It encourages the development of new products and services by providing an affordable mechanism to insure against certain risks. It frees funds designated for insurance purchase for much needed capital investment. Most importantly, self insurance, in combination with the purchase of traditional insurance, allows the corporation to secure the broadest coverage at the least cost. Given these facts, it makes no sense to exclude qualified self-insurance reserves as a permissible tax deduction. As the reserves of the self insurer and commercial insurer serve the same purpose and are subject to the same claim liability, there is no rational reason for differentiating their treatment for tax purposes.

RIMS is keenly aware that the Subcommittee is examining all legislative proposals with an eye towards revenue enhancement. Tax Code recognition for self-insurance reserving practices is not incompatible with this goal. That portion of the cost which the corporation will seek to deduct as self insurance would be lower than the deduction now obtained through the purchase of insurance, because neither the profit nor overhead of the insurance carrier is included. Thus, a lower deduction would be claimed by the self insurer than by his counterpart purchasing first dollar coverage. In addition, the amount saved by the self insurer is added to its tax base, providing additional potential revenue for the Treasury.

Moreover, wider use of self-insurance funding should enhance tax revenues because fewer deductible losses are incurred by the self insurer. An editorial in the trade publication Business Insurance (Nov. 22, 1982, page 8) stated, "It is quite clear from the experience in the United States that a company that pays its losses out of its own pocket in the first instance is more serious about controlling losses than the fully insured company." Companies that do self insure are aggressive about loss prevention, because the losses are felt directly on the corporate bottom line. Besides the tremendous benefit to society of fewer injuries and losses, the fiscal impact on the U.S. Treasury is clear. Fewer losses mean fewer deductions, and fewer deductions mean more tax dollars collected.

In determining how to implement an equitable tax policy for both insured and self insured, RIMS urges the Subcommittee to consider the comprehensive approach taken by Rep. Frenzel in H.R. 2642, introduced on April 20, 1983. The legislation provides for a formal statutory arrangement

whereby a taxpayer can comply with the Kaiser decision, but, in addition to workers' compensation liabilities, it would encompass reserves set aside for tort liability claims and fraud or defalcations incurred by financial institutions.

In order to qualify for the tax deduction under H.R. 2642, the loss reserve funds must be set aside in:

1. A self-insurance trust which would be somewhat comparable to the trust arrangement that presently exists under section 501(c)9 of the Code and is used to provide coverages for certain employee benefit programs;
2. A standby trust supported by an appropriate surety bond or letter of credit. This same approach was proposed in connection with certain environmental liability programs by the Environmental Protection Agency;
3. Affiliated insurers which are your so-called captives. H.R. 2642 wording follows the definition for affiliated insurers found in the Federal Risk Retention Act; and
4. Unaffiliated Insurers - These are commercial insurers which administer programs for the insured which contain substantial elements of self insurance.

The test for tax deductibility under an affiliated or unaffiliated insurer's program would be directly related to premium. Under a trust, it would be based on amounts determined in any reasonable manner that may be acceptable to the Secretary of Treasury. The bill also permits amounts

to be set aside based upon determinations made by an independent and qualified actuary or loss reserve specialist. The amount set aside may also be based on an amount equal to 90% of what the taxpayer would have to pay a commercial insurer for coverage of the taxpayer's current liability for self-insured losses. This amount would be determined on the basis of a quotation from a licensed insurance carrier or brokerage firm.

There would be an annual recalculation of the liabilities covered by the trust at the end of each year to determine the adequacy of the deductions. In the event of a surplus, the excess in the reserve would be repatriated to the self insured and treated as gross income for tax purposes.

If the trust approach is used, the taxpayer's ability to terminate the trust is strictly limited. Termination is only permissible when:

1. The taxpayer has not taken a deduction for losses self-insured through the trust in any of the five previous tax years;
2. There are no outstanding claims of liability with respect to the risks the taxpayer self-insured through the trust;
3. The applicable statute of limitations has run on all risks self-insured through the trust, or the risk is transferred to a licensed insurer.

These stringent termination conditions are designed to protect potential claimants by providing safeguards that the taxpayer will be around to pay loss claims when they become due.

In conclusion, RIMS urges this Subcommittee to consider the approach taken in H.R. 2642 as a responsible solution to the needs of the public, American industry and the United States Treasury. It would provide the framework in the Tax Code for the Kaiser case to be implemented with certitude, consistency, and fairness by the Internal Revenue Service. It would encourage the formation of sound financial arrangements for the payment of potential claimants. It would eliminate the dysfunctional incentive to purchase potentially more costly commercial insurance to obtain a tax deduction. This would benefit the Treasury, as a lesser deduction for insurance would be taken by the corporate taxpayer than if it would have purchased commercial insurance. It would simultaneously benefit the business community, because it would free capital used for the purchase of insurance to meet vital operating needs and capital investment requirements.

A deduction taken for contribution to a self-insurance reserve is not an accounting abuse, but a recognition of economically sound and socially important risk management and risk financing techniques.

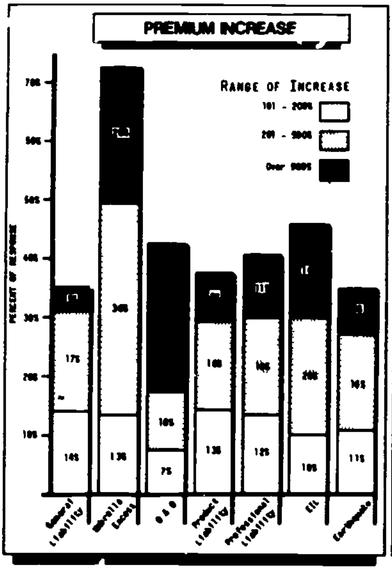
Risk and Insurance Management Society, Inc.
205 East 42nd Street
New York, New York 10017

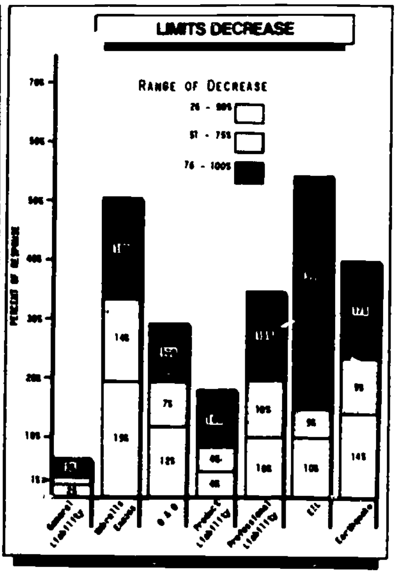
MANAGEMENT REPORT

INSURANCE AVAILABILITY SURVEY

Risk and Insurance Management Society, Inc.

KEY FINDINGS





UMBRELLA/EXCESS

- 28% had over 500% increase in premiums
- 18% had over 75% decrease in limits
- 17% forced to take claims - made coverage
- 71% expressed interest in group solution

DIRECTORS' & OFFICERS' LIABILITY

- 26% had over 500% increase in premiums
- 22% had over 200% increase in deductibles
- 10% had over 75% decrease in limits
- 55% expressed interest in group solution

ENVIRONMENTAL IMPAIRMENT LIABILITY

- 37% reported insurance was "unavailable"
- 33% had over 75% decrease in limits
- 44% report coverage was "highly restricted"
- 67% expressed interest in group solution

INTRODUCTION

Background

As insurance market conditions deteriorated during 1985, the Risk and Insurance Management Society (RIMS) became increasingly concerned that it should have an active role in helping its members devise practical, long-term solutions to their individual insurance problems. Internal discussions at RIMS resulted in the establishment of an Ad Hoc Advisory Committee to devise a means by which RIMS could provide assistance to members. The Committee members concluded that RIMS's proper and most effective role would be as a source of information, advice and informal support for its members' efforts to communicate to their management and to facilitate efforts to devise solutions.

The Committee decided to conduct a survey of RIMS members to determine both the extent of the insurance crisis at the conclusion of year-end 1985 renewals, and the members' interest in pursuing alternatives to purchasing insurance.

The survey meets two objectives:

1. To gather information necessary for an analysis of the impact of current insurance market conditions on individual organizations' and industries' insurance programs. This will allow members to provide their management with specific data, and will provide data to regulators, legislators and others.

2. To identify groups of organizations with common insurance problems, including general industry groups and geographic groups. This permits members to better communicate in formulating alternative risk financing methods.

Tillinghast, Nelson & Warren, Inc, (Tillinghast) assisted RIMS in designing the survey, tabulating data, interpreting results and devising courses of action. Tillinghast will also be analyzing the data to identify groups with common problems.

About The Survey

RIMS designed a survey form which requested information about the conditions encountered in the most recent renewal of 12 commercial insurance coverages. Specific questions were identified for coverage availability, cost, limits, deductibles and terms and conditions. The form also requested demographic information about each respondent, which was used for computing and evaluating responses. A copy of the questionnaire is included as Appendix D. The survey was mailed to 3,709 RIMS members on January 2, 1985. The results presented here were developed from the 1,176 responses received by February 14, 1986.

Respondent Profile

Firms ranged in size from $1 million in annual revenues to $96 billion.* Respondents are located in 46 U.S. states, the District of Columbia, and

several Canadian provinces. Ninety-five Canadian firms returned surveys. Virtually every sector of the economy was represented. Industry groups which responded well include banks, hospitals, universities, oil and gas producers, electric utilities, and retail grocers. In addition, many governmental entities responded. A listing of the individual industry groups and their Standard Industrial Classification (SIC) codes is attached as Appendix A.

Conclusions

The survey results confirm that the insurance market has deteriorated significantly. This deterioration has affected some lines of insurance and some industry groups more than others. Few signs indicate that the situation will improve soon - in fact, it may worsen in some areas. There is also evidence that:

- Insurance market conditions deteriorated rapidly and drastically during and after the 4th quarter renewals in 1984. Premiums increased rapidly, limits decreased, and retentions increased. This deterioration continues to the present.

- Almost every coverage studied created a serious problem for insurance buyers. In some lines, such as auto liability, only premium increases concerned respondents. For others, such as flood/earthquake (earthquake), coverage has been difficult to obtain, at generally insufficient limits. In some cases, especially in umbrella/excess and directors' and officers' liability lines, adequate coverage and reasonable limits, retentions, and premiums have been difficult, if not impossible, to find.

- A surprising number of respondents indicated that they did not purchase coverages: 12% for directors' and officers' liability, 24% for product liability, 31% for professional liability, and 35% for environmental impairment liability (EIL).

- The insurance market crisis has affected virtually all sectors of the U.S. economy. Some industry groups such as government, universities and hospitals have suffered much more than others. Other sectors, including general manufacturing and wood products, have nearly as many difficulties. Many others have faced significant problems with respect to specialized coverages, such as EIL in the chemical and mining sectors, or professional liability in construction and financial institutions. Small and large firms alike have experienced similar difficulties. Adverse market conditions affected Canadian firms nearly as badly as they did U.S. firms.

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* For ease of data tabulation, firms were placed into one of seven size categories, with respect to revenues, sales, deposits or budget. These were (numbers of respondents are indicated in parenthesis): under $10 million (23), $10-$50 million (74), $50-$100 million (117), $100-$500 million (346), $500 million-$1 billion (188), $1-$10 billion (321), and over $10 billion (44). 63 respondents did not provide financial information.

I. SUMMARY OF SURVEY FINDINGS

The survey results confirm that in most lines of coverage, availability, premiums, limits, and coverage terms have deteriorated significantly. The most severe problems pertain to the sudden and drastic change in limits and premiums over time. All data tables are contained in Appendix B.

Change Over Time

Four lines of insurance were examined with respect to change over time: umbrella/excess (Table 1), directors' and officers' liability (D&O) (Table 2), earthquake (Table 3) and auto liability (Table 4). Areas demonstrating significant change over time have been enclosed in a box. The tables show for each quarter the percent of the respondents' renewals which experienced a given change in premium or limits, or in the case of D&O, obtained a specified limit. The number of companies which responded to the appropriate survey question concerning change in premium, change in limit, or D&O limit is shown, as well.

For three lines, a significant shift appeared between 4th quarter, 1984 and 1st quarter, 1985. For D&O, limits purchases declined: 18% of the 4th quarter renewals purchased limits of $1-$5 million, compared to 29% of the renewals in 1st quarter. For earthquake, premiums increased: 57% of the 4th quarter renewals saw premiums increase less than 10%, compared to 24% in the following quarter. Premiums also increased for umbrella/excess: only 4% of the renewals in 1st quarter, 1985 had increases of less than 10%, compared to 20% in the previous quarter.

These problems persisted throughout 1985. In umbrella/excess, 67% of the 1st quarter renewals faced at least a 100% increase in premium, and 10% faced at least a 50% decrease in limits. By the 4th quarter renewal, 81% had this level of premium increase, while 48% experienced those limit changes. Similarly, in D&O, 44% of the 1st quarter renewals had premiums rise at least 100% and 6% had limits fall at least 50%. By the 4th quarter, 80% and 30% of the renewals experienced those premium and limit changes, respectively.

To a certain degree, these problems have spread to other lines of coverage. For example, while relatively few respondents indicated unusual trouble with their auto liability renewals, there was a deterioration over the course of the year. 16% of the 1st quarter, 1985 renewals saw premiums increase over 100%. This increased to 31% in the 4th quarter. While we do not expect this trend to continue, it is indicative of the pervasiveness of rate increases.

Other Significant Problems

Many respondents indicated that they faced problems with other specialized coverages. Problems ranged from "severe changes in premiums, limits or deductible" to "cancellation" or "complete unavailability". 240 respondents reported these difficulties with crime coverage, 136 with excess workers' compensation, and 124 with fiduciary liability.

Other significant problems affected a number of respondents. 17% reported that their carriers required them to accept claims-made coverage as a condition to

obtaining umbrella/excess insurance. 7% reported that claims-made coverage was required in their primary general liability insurance. Finally, 10% of the respondents indicated that they were forced to curtail or change their business operations because they could not find reasonable insurance coverage. Many reported cancelled expansions, discontinued product lines, fewer suppliers of needed raw materials, and much more time, energy and money devoted to insurance marketing, claims, defense and other expenses. Appendix C provides samples of some of the more notable comments respondents made on their surveys.

Many respondents appear interested in alternatives to purchasing commercial insurance. 71% of the respondents indicated that they would like to pursue alternatives to commercially purchased umbrella/excess insurance, and 67% would like to do so for EIL insurance. Table 5 contains a summary of the interest of respondents in group solution for each line of coverage.

II. MARKET CONDITIONS BY LINE OF COVERAGE

The survey originally sought information about 13 common lines of commercial insurance — three of these are not included in this analysis because of the low number of responses: Aviation Fleet Liability; "Other" Liability; and "Other" Property. A summary of market conditions for each line of insurance is presented below. Data are taken from Tables 6-10 in Appendix B. In Table 6, virtually all the respondents who indicated "Did Not Purchase" probably attempted to locate coverage.

A. Primary General Liability: 1,114 respondents. Limits and deductibles remained fairly stable, but availability was somewhat curtailed and premiums increased significantly.

- o Availability: "Much Difficulty" or "Unavailable" for 24% of the respondents.
- o Premiums: Increased over 100% for 36% of the respondents
- o Coverage conditions: "Somewhat" or "Highly" restricted for 50% of the respondents.
- o Sectors particularly affected: computers, hospitals, governmental entities, transit, universities.

B. Umbrella/Excess Liability: 1,125 respondents. Availability was severely curtailed, and premiums soared. These problems affected every industry sector.

- o Availability: "Much Difficulty" for 64% of the respondents; "Unavailable" for 13%.
- o Premiums: Increased between 201%-500% for 36% of the respondents; over 500% for 25% of the respondents.
- o Limits: Down between 76%-100% for 18% of the respondents.
- o Conditions: "Highly" restricted for 19% of the respondents; "Somewhat" restricted for 51%.
- o Sectors particularly affected: all.

C. Auto Liability: 420 respondents. Few significant problems were reported. Premiums increased significantly for some respondents, but limits, deductibles, availability, and conditions remained steady.

- o Premiums: 31% report increases of over 100%.

D. Directors' & Officers' Liability: 964 respondents. Limits decreased and deductibles rose for many respondents, apparently forcing them to self-insure this exposure. Any coverage they located carried significantly higher premiums, and more restrictive conditions.

- Availability: 41% report "Much Difficulty" or "Unavailable"; 12% did not purchase.
- Premiums: 36% report increase of over 200%.
- Limits: 10% report decrease of over 75%; 19% report decrease between 25%-75%.
- Deductibles: 22% report increase of over 200%.
- Conditions: 16% report "Highly" restricted; 35% report "Somewhat" restricte.
- Sectors particularly affected: all.

E. Product Liability: 237 respondents. Limits and deductibles were stable, and premiums increased somewhat for some respondents. Availability of reasonable coverage presented problems, as conditions of coverage became more strict and several chose not to purchase it at all.

- Availability: 24% had "Much Difficulty" in locating coverage, and 24% did not purchase.
- Premiums: 37% report increase of over 100%.

F. Professional Liability: 420 respondents. Premiums increased for those respondents finding coverage. Limits and deductibles were fairly stable, but coverage conditions were fairly restricted.

- Availability: 26% report "Much Difficulty" in locating, and 11% report "Unavailable". 31% did not purchase.
- Premiums: 29% report increase of over 200%.
- Limits: 35% report decrease of over 25%.
- Sectors particularly affected: construction, financial institutions, hospitals, services, governmental entities, universities.

G. Environmental Impairment Liability: 585 respondents. Few respondents located coverage. What insurance was available carried much lower limits, fairly higher premiums and deductibles, and quite restricted conditions.

- Availability: 37% report "Unavailable"; 18% report "Much Difficulty" in locating. 14% were not renewed, and 35% did not purchase it.
- Premiums: 36% report increase over 200%.
- Limits: 39% report decrease over 75%.
- Deductibles: 26% report increase over 200%.

- o Conditions: 44% report "Highly" restricted; 26% report "Somewhat" restricted.

- o Sectors particularly affected: chemicals, computers, wood products, machinery, metals, mining, governmental entities.

H. Bankers' Blanket Bond: 399 respondents. Coverage appeared fairly stable, although deductibles increased substantially for some.

- o Deductible: 42% report increase over 50%.

- o Sectors affected: Banking.

I. Property Damage: 1043 respondents. Many respondents report significant premium increases and curtailed coverage, and some found availability was restricted. Limits and deductibles remained stable.

- o Availability: 18% report "Much Difficulty".

- o Premiums: 35% report increase between 51% and 500%.

- o Conditions: 30% report "Somewhat" restricted.

- o Sectors particularly affected: retail grocers, governmental entities.

J. Flood/Earthquake: 757 respondents. Availability and limits were significantly curtailed. Some respondents faced fairly steep premium increases, although deductibles and conditions did not change much.

- o Availability: 40% report "Much Difficulty" or "Unavailable".

- o Premiums: 24% report increase over 200%.

- o Limits: 17% report decrease over 75%.

- o Sectors particularly affected: electric utilities, wood products, machinery, governmental entities.

APPENDIX A

Industrial Sectors

Category		SIC Codes	Number
Mining		1000-1499	50
Oil and Gas	Refining	1311	44
	Service	1382	
	Supply	2911	
Construction		1500-1799	45
Food:	Agriculture	0100-0999	96
	Food	2000-2099	
	Tobacco	2100-2199	
Textiles:	Textiles	2200-2299	27
	Clothing	2300-2399	
	Leather	3100-3199	
Wood Products	Lumber	2400-2499	73
	Furniture	2500-2599	
	Paper	2600-2699	
	Printing	2700-2799	
Chemicals:	Chemicals	2800-2899	96
	Oil	2900-2999	
	Rubber	3000-3099	
Metals	Stone	3200-3299	
	Metals	3300-3399	89
	Metal Products	3400-3499	
Machinery:	Machinery	3500-3599	162
	Electrical Equipment	3600-3699	
	Transportation Equipment	3700-3799	
	Instruments	3800-3899	
	Miscellaneous Manufacturing	3900-3999	
Computer		3573	15
Transit Services		4000-4799	62
Utilities		4800-4999	74
Electrical Utilities		4911,4931	43
Wholesale Trade		5000-5199	90
Retail Trade		5200-5999	67
Retail Grocery		5411	23
Financial Institutions		6000-6999	120
Banks		6022,6025	43
Services		7000-7999	78
Hospitals		8062	31
Universities		8221	34
Other/Miscellaneous		8000-9999	60
Government		N/A	83
			1,505*

* Some respondents indicated more than one sector.

APPENDIX B

Table 1

Umbrella/Excess

Changes In Premiums And Limits At Last Renewal

	Premium Percent Increase: Less Than 10%	10-100%	Over 100%	#	Limits Percent Decrease: Less Than 10%	10-50%	Over 50%	#
1984								
1st Qtr	100%	0%	0%	1	100%	0%	0%	1
2nd Qtr	0%	25%	75%	4	50%	25%	25%	4
3rd Qtr	25%	13%	63%	8	50%	13%	38%	8
4th Qtr	20%	15%	65%	20	63%	11%	26%	19
1985								
1st Qtr	4%	30%	67%	183	61%	28%	10%	181
2nd Qtr	4%	21%	76%	284	43%	31%	26%	280
3rd Qtr	4%	13%	83%	204	38%	31%	31%	200
4th Qtr	2%	17%	81%	313	30%	21%	48%	312

Table 2

Directors' and Officers' Liability

Changes In Premiums and Limits At Last Renewal

	Premium Percent Increase				Limits Dollar Amount					Limits Percent Decrease			
	Less Than 10%	10-100%	Over 100%	#	$1-$5Mil	$6-$10Mil	$11-$25Mil	Over $25Mil	#	Less Than 10%	10-50%	Over 50%	#
1983													
1st Qtr	29%	35%	35%	17	24%	26%	32%	18%	34	91%	0%	9%	22
2nd Qtr	88%	8%	4%	25	18%	4%	39%	39%	28	87%	13%	0%	23
3rd Qtr	79%	5%	16%	19	30%	9%	35%	26%	23	100%	0%	0%	18
4th Qtr	85%	5%	10%	20	24%	12%	36%	28%	25	90%	5%	5%	20
1984													
1st Qtr	75%	4%	21%	21	4%	21%	50%	25%	24	90%	10%	0%	21
2nd Qtr	70%	10%	20%	30	5%	34%	39%	21%	38	85%	10%	7%	30
3rd Qtr	57%	30%	13%	30	10%	17%	47%	27%	30	87%	10%	3%	30
4th Qtr	41%	30%	30%	37	18%	11%	31%	40%	45	84%	5%	11%	37
1985													
1st Qtr	21%	35%	44%	96	29%	16%	32%	23%	105	84%	10%	6%	93
2nd Qtr	29%	36%	35%	106	29%	19%	26%	25%	154	57%	25%	19%	162
3rd Qtr	8%	20%	73%	142	32%	24%	27%	17%	138	62%	25%	13%	120
4th Qtr	6%	14%	80%	162	30%	23%	31%	16%	145	45%	25%	30%	162

Table 3

Earthquake

Changes In Premiums And Limits At Last Renewal

	Premium Percent Increase				Limits Percent Decrease			
	Less Than 10%	10-100%	Over 100%	#	Less Than 10%	10-50%	Over 50%	#
1983								
1st Qtr	100%	0%	0%	1				0
2nd Qtr	100%	0%	0%	6	100%	0%	0%	7
3rd Qtr	60%	40%	0%	5	75%	25%	0%	4
4th Qtr	67%	0%	33%	3	67%	0%	33%	3
1984								
1st Qtr	67%	33%	0%	3	100%	0%	0%	1
2nd Qtr	57%	29%	14%	7	60%	0%	40%	5
3rd Qtr	75%	25%	0%	4	67%	33%	0%	3
4th Qtr	57%	14%	29%	14	60%	10%	30%	10
1985								
1st Qtr	24%	41%	34%	90	53%	25%	22%	87
2nd Qtr	27%	36%	38%	157	55%	20%	25%	165
3rd Qtr	26%	35%	39%	119	49%	19%	32%	119
4th Qtr	28%	34%	38%	148	53%	20%	27%	172

Table 4

Auto Liability

Change in Premiums at Last Renewal

Premium
Percent Increase

	Less Than 10%	10-100%	Over 100%	#
1984				
1st Qtr	0%	0%	100%	1
2nd Qtr	100%	0%	0%	2
3rd Qtr	0%	100%	0%	1
4th Qtr	36%	50%	14%	14
1985				
1st Qtr	45%	39%	16%	116
2nd Qtr	28%	47%	25%	185
3rd Qtr	20%	51%	29%	123
4th Qtr	20%	49%	31%	245

Table 5

Interest In Group Solution

		Yes	NO
A.	Primary General Liability	39%	61%
B.	Umbrella/Excess Liability	$\boxed{71\%}$	29%
C.	Auto Liability	24%	76%
D.	Directors' & Officers' Liability	$\boxed{55\%}$	45%
E.	Product Liability	40%	60%
F.	Professional Liability	$\boxed{52\%}$	48%
G.	Pollution/Environmental	$\boxed{67\%}$	33%
H.	Banker's Blanket Bond	30%	70%
I.	Property Damage/Business Interruption	24%	76%
J.	Flood/Earthquake	33%	67%

Table 6

Availability

	Easy to Purchase	Somewhat Difficult	Much Difficulty	Unavailable	Not Renewed By Carrier	Cancelled	Not Purchased
A. Primary General Liability	33%	39%	22%	2%	6%	6%	5%*
B. Umbrella/Excess Liability	5%	25%	64%	13%	13%	4%	5%
C. Auto Liability	52%	33%	11%	1%	4%	1%	3%
D. Directors' & Officers' Liability	24%	24%	36%	5%	[illegible]%	7%	12%
E. Product Liability	24%	24%	24%	8%	6%	3%	24%
F. Professional Liability	15%	21%	26%	11%	9%	4%	31%
G. Pollution/Environmental	6%	9%	18%	37%	14%	3%	35%
H. Banker's Blanket Bond	24%	24%	12%	1%	2%	1%	2%
I. Property Damage/Business Interruption	38%	42%	18%	1%	2%	2%	3%
J. Flood/Earthquake	24%	20%	34%	6%	4%	3[illegible]	11%

* Rows do not sum to 100% because multiple responses were permitted.

Table 7

Change in Premiums

	Decrease	No Change	Increase 1-10%	Increase 11-50%	Increase 51-100%	Increase 101-200%	Increase 201-500%	Increase Over 500%
A. Primary General Liability	2%	5%	11%	28%	16%	14%	17%	5%
B. Umbrella/Excess Liability	1%	2%	2%	8%	12%	13%	36%	28%
C. Auto Liability	3%	13%	16%	36%	2%	16%	13%	2%
D. Directors' & Officers' Liability	6%	16%	5%	11%	9%	7%	10%	26%
E. Product Liability	-	13%	10%	22%	18%	13%	16%	8%
F. Professional Liability	4%	10%	8%	19%	18%	12%	18%	11%
G. Pollution/Environmental	2%	17%	5%	18%	12%	10%	20%	16%
H. Banker's Blanket Bond	[illegible]%	18%	13%	23%	13%	9%	11%	7%
I. Property Damage/Business Interruption	4%	8%	12%	40%	16%	9%	10%	1%
J. Flood/Earthquake	2%	15%	8%	26%	14%	11%	16%	8%

Table 8

Changes in Limits

	Increase	No Change	Decrease 1-10%	Decrease 11 25%	Decrease 26-50%	Decrease 51 75%	Decrease 76 100%
A. Primary General Liability	22%	70%	1%	1%	2%	1%	3%
B. Umbrella/Excess Liability	4%	34%	3%	8%	19%	14%	18%
C. Auto Liability	18%	77%	1%	1%	1%	1%	1%
D. Directors' & Officers' Liability	12%	53%	2%	5%	12%	7%	10%
E. Product Liability	17%	62%	1%	2%	4%	4%	10%
F. Pro ,sional Liability	9%	54%	1%	2%	10%	10%	15%
G. Pollution/Environmental	1%	40%	2%	4%	10%	5%	39%
H. Banker's Blanket Bond	12%	76%	1%	3%	5%	1%	2%
I. Property Damage/Business Interruption	22%	63%	4%	3%	4%	2%	2%
J. Flood/Earthquake	6%	46%	2%	6%	14%	9%	17%

Table 9

Change in SIR/Deductible

	Decrease	No Change	Increase 1-10%	Increase 11-50%	Increase 51 100%	Increase 101 200%	Increase 201 500%	Increase Over 500%
A. Primary General Liability	1%	64%	2%	4%	9%	6%	8%	5%
B. Umbrella/Excess Liability	1%	78%	1%	2%	8%	3%	3%	3%
C. Auto Liability	2%	77%	1%	4%	6%	5%	3%	3%
D. Directors' & Officers' Liability	4%	49%	3%	7%	8%	7%	10%	12%
E. Product Liability	-	58%	4%	6%	10%	7%	8%	7%
F. Professional Liability	2%	59%	1%	4%	11%	6%	9%	8%
G. Pollution/Environmental	-	53%	1%	5%	12%	3%	13%	10%
H. Banker's Blanket Bond	1%	51%	1%	4%	10%	10%	10%	12%
I. Property Damage/Business Interruption	2%	62%	4%	8%	8%	5%	7%	4%
J. Flood/Earthquake	2%	55%	3%	7%	10%	7%	7%	8%

Table 10

Conditions of Coverage

	Improved	No Change	Somewhat Restricted	Highly Restricted
A. Primary General Liability	3%	46%	43%	7%
B. Umbrella/Excess Liability	1%	29%	51%	19%
C. Auto Liability	2%	86%	10%	2%
D. Directors' & Officers' Liability	7%	42%	35%	16%
E. Product Liability	-	61%	25%	14%
F. Professional Liability	3%	59%	27%	11%
G. Pollution/Environmental	2%	28%	26%	44%
H. Banker's Blanket Bond	7%	71%	18%	5%
I. Property Damage/Business Interruption	8%	58%	30%	3%
J. Flood/Earthquake	3%	62%	29%	7%

APPENDIX C

EXHIBIT I-1

This Exhibit is a compilation of answers to the question "Have you been forced to curtail or change your business operations because you could not obtain reasonable insurance coverage? If "yes", please elaborate in the "Additional Comments" section below."

"Our engineers were going to form a subsidiary for design consulting. Engineers E&O scratched that."

"Are avoiding contracts for replacement of PCB contaminated equipment if we must assume liability for pollution exposure."

"Because of heavy workers' compensation awards and being a strict labor leasing organization we have had to drop customers and will look at droppin out of certain states."

"Fertilizer plants - ceased fleet operations for two weeks until $5 million vehicle liability could be placed."

"Have had to escrow funds over cancelled surety bonds and E.I.L., have had to turn down potential customers who wanted performance bonds ... we have been stunned at the difficulty to placing our 1986 workers' comp.!"

"Curtail transporting senior citizens and children to various recreation activities."

"As a municipal government with very restricted revenue increases possible, significant service reductions may be impossible to avoid as a direct result of the (un)availability of insurance. Governments can not be risk seekers."

"Renewal of Umbrella Liability excluded over D & O/Professional Liability, which was covered previously. Work of one of our Research Institutes is curtailed because of inability to obtain Professional Liability coverage for work involving design of computer systems for industry."

"We have been unable to acquire any coverage for athletic participation (the City's entire recreation program) or for the City's dams and water reservoirs. This poses some real problems, since the City cannot stop providing water to its citizens."

"One subsidiary cannot take "fairness opinion" business because we cannot find an insurer willing to underwrite the risk."

"No real changes yet, but it is anticipated; our real estate portfolio is 25% hotels and we are attempting to sell these locations ASAP because of the exposures."

"Assume considerable liability that previously was covered and hope to God nothing happens."

APPENDIX D

INSURANCE AVAILABILITY SURVEY

The Risk and Insurance Management Society, Inc. (RIMS) has retained the services of Tillinghast, Nelson & Warren, Inc. to assist in the tabulation of survey information. Tillinghast, Nelson & Warren, Inc., has agreed to preserve in confidence any information disclosed to them in connection with this survey, to use the information solely for the purposes of the survey, and to return all documents to RIMS at the conclusion of the work. Individual survey responses will be destroyed by RIMS upon their return by Tillinghast.

Please retain a copy of the completed survey form.

Please return by JANUARY 20, 1986 to:

RESEARCH DEPARTMENT
Risk and Insurance Management Society, Inc.
205 East 42nd Street
New York, N.Y. 10017

Risk and Insurance Management Society, Inc.

Insurance Availability Survey

I. Contact Information

Name: ____________________

Title: ____________________

Company Name: ____________________

Address: ____________________

____

Telephone: (______) ____________________

II. General Information

A. How large is your organization? Please check the appropriate measure (typically revenues or gross sales, but deposits if a bank, budget if a unit of government or university, etc.) and give either the actual figure or an estimate for 1985.

A.1. 1985 [ ] Revenues $ ____________

[ ] Gross Sales

[ ] Deposits

[ ] Budget

Please estimate the total number of employees in your organization (include both full-time and part-time employees).

A.2. 1985 Employees: ____________

B. What type of industry? In question B.1, please provide up to three 4 digit Standard Industrial Classification (SIC) codes which are representative of your major activities as determined by the product, group of products produced or handled, or service rendered. (If you use a 2 or 3 digit code, please provide that code.) If your organization does not have an SIC code, e.g. a municipality, or a Canadian company, please write N.A.

B.1. SIC Code(s): ______ ______ ______

Please provide a one to three word description of each of your organization's three primary functions, e.g. primary care hospital, commercial bank, clothing retailer, etc.

B.2. Brief description: ____________________

____

____

III. Insurance Program — Please indicate for each coverage listed below the market conditions you have found during your most recent renewal. For column 2, please check all that apply. If you indicate an interest in column 7 for umbrella/excess liability, please also check which layers of coverage you are interested in. If any specific liability coverage is part of a primary general liability package policy, please check the appropriate space by the title of that specific policy. If you wish to elaborate on any specific response, feel free to do so in the "Additional Comments" section at the end of this survey.

(1) Coverage	(2) Availability	(3) Premium Change	(4) Limit Change	(5) Deductible/ Retention/SIR Change	(6) Coverage Conditions	(7) Are you interested in exploring coverage in a group solution?
A. Primary General Liability	1.[ ] Easy to Purchase	1.[ ]decrease	1.[ ]increase	1.[ ]decrease	1.[ ] Improved	[ ] No
Current limits: $________	2.[ ] Some Difficulty	2.[ ]no change	2.[ ]no change	2.[ ]no change	2.[ ] No Change	[ ] Yes
Last renewed date ________ mo/yr	3.[ ] Much Difficulty	3.[ ]up 1-10%	3.[ ]down 1-10%	3.[ ]up 1-10%	3.[ ] Somewhat Restricted	
	4.[ ] Unavailable	4.[ ]up 11-50%	4.[ ]down 11-25%	4.[ ]up 11-50%	4.[ ] Highly Restricted	
	5.[ ] Not renewed by carrier	5.[ ]up 51-100%	5.[ ]down 26-50%	5.[ ]up 51-100%		
	6.[ ] Cancellation since 7/1/84	6.[ ]up 101-200%	6.[ ]down 51-75%	6.[ ]up 101-200%		
	7.[ ] Did not purchase	7.[ ]up 201-500%	7.[ ]down 76-100%	7.[ ]up 201-500%		
		8.[ ]up over 500%		8.[ ]up over 500%		
B. Umbrella/Excess Liability	1.[ ] Easy to Purchase	1.[ ]decrease	1.[ ]increase	1.[ ]decrease	1.[ ] Improved	[ ] No
Current limits: $________	2.[ ] Some Difficulty	2.[ ]no change	2.[ ]no change	2.[ ]no change	2.[ ] No Change	[ ] Yes
Last renewed date ________ mo/yr	3.[ ] Much Difficulty	3.[ ]up 1-10%	3.[ ]down 1-10%	3.[ ]up 1-10%	3.[ ] Somewhat Restricted	If "yes", in which layers:
	4.[ ] Unavailable	4.[ ]up 11-50%	4.[ ]down 11-25%	4.[ ]up 11-50%	4.[ ] Highly Restricted	[ ]$1-10mil
	5.[ ] Not renewed by carrier	5.[ ]up 51-100%	5.[ ]down 26-50%	5.[ ]up 51-100%		[ ]$11-50mil
	6.[ ] Cancellation since 7/1/84	6.[ ]up 101-200%	6.[ ]down 51-75%	6.[ ]up 101-200%		[ ]$51-100mil
	7.[ ] Did not purchase	7.[ ]up 201-500%	7.[ ]down 76-100%	7.[ ]up 201-500%		[ ]over $100 mil
		8.[ ]up over 500%		8.[ ]up over 500%		
C. Auto Liability	1.[ ] Easy to Purchase	1.[ ]decrease	1.[ ]increase	1.[ ]decrease	1.[ ] Improved	[ ] No
[ ] Included in A.	2.[ ] Some Difficulty	2.[ ]no change	2.[ ]no change	2.[ ]no change	2.[ ] No Change	[ ] Yes
Current limits: $________	3.[ ] Much Difficulty	3.[ ]up 1-10%	3.[ ]down 1-10%	3.[ ]up 1-10%	3.[ ] Somewhat Restricted	
Last renewed date ________ mo/yr	4.[ ] Unavailable	4.[ ]up 11-50%	4.[ ]down 11-25%	4.[ ]up 11-50%	4.[ ] Highly Restricted	
	5.[ ] Not renewed by carrier	5.[ ]up 51-100%	5.[ ]down 26-50%	5.[ ]up 51-100%		
	6.[ ] Cancellation since 7/1/84	6.[ ]up 101-200%	6.[ ]down 51-75%	6.[ ]up 101-200%		
	7.[ ] Did not purchase	7.[ ]up 201-500%	7.[ ]down 76-100%	7.[ ]up 201-500%		
		8.[ ]up over 500%		8.[ ]up over 500%		

(Continued)

III. Insurance Program--Please indicate for each coverage below the market conditions you have found during your most recent renewal.

(1) Coverage	(2) Availability	(3) Premium Change	(4) Limit Change	(5) Deductible/ Retention/SIR Change	(6) Coverage Conditions	(7) Are you interested in exploring coverage in a group solution?
D. Directors' & Officers' Liability Current limit: $ ________ Last renewed date ________ mo/yr	1.[ ] Easy to Purchase 2.[ ] Some Difficulty 3.[ ] Much Difficulty 4.[ ] Unavailable 5.[ ] Not renewed by carrier 6.[ ] Cancellation since 7/1/84 7.[ ] Did not purchase	1.[ ]decrease 2.[ ]no change 3.[ ]up 1-10% 4.[ ]up 11-50% 5.[ ]up 51-100% 6.[ ]up 101-200% 7.[ ]up 201-500% 8.[ ]up over 500%	1.[ ]increase 2.[ ]no change 3.[ ]down 1-10% 4.[ ]down 11-25% 5.[ ]down 26-50% 6.[ ]down 51-75% 7.[ ]down 76-100%	1.[ ]decrease 2.[ ]no change 3.[ ]up 1-10% 4.[ ]up 11-50% 5.[ ]up 51-100% 6.[ ]up 101-200% 7.[ ]up 201-500% 8.[ ]up over 500%	1.[ ] Improved 2.[ ] No Change 3.[ ] Somewhat Restricted 4.[ ] Highly Restricted	[ ] No [ ] Yes
E. Product Liability [ ] Included in A. Current limit: $ ________ Last renewed date ________ mo/yr Product type: ________	1.[ ] Easy to Purchase 2.[ ] Some Difficulty 3.[ ] Much Difficulty 4.[ ] Unavailable 5.[ ] Not renewed by carrier 6.[ ] Cancellation since 7/1/84 7.[ ] Did not purchase	1.[ ]decrease 2.[ ]no change 3.[ ]up 1-10% 4.[ ]up 11-50% 5.[ ]up 51-100% 6.[ ]up 101-200% 7.[ ]up 201-500% 8.[ ]up over 500%	1.[ ]increase 2.[ ]no change 3.[ ]down 1-10% 4.[ ]down 11-25% 5.[ ]down 26-50% 6.[ ]down 51-75% 7.[ ]down 76-100%	1.[ ]decrease 2.[ ]no change 3.[ ]up 1-10% 4.[ ]up 11-50% 5.[ ]up 51-100% 6.[ ]up 101-200% 7.[ ]up 201-500% 8.[ ]up over 500%	1.[ ] Improved 2.[ ] No Change 3.[ ] Somewhat Restricted 4.[ ] Highly Restricted	[ ] No [ ] Yes
F. Professional Liability [ ] Included in A. Current limit: $ ________ Last renewed date ________ mo/yr Profession ________	1.[ ] Easy to Purchase 2.[ ] Some Difficulty 3.[ ] Much Difficulty 4.[ ] Unavailable 5.[ ] Not renewed by carrier 6.[ ] Cancellation since 7/1/84 7.[ ] Did not purchase	1.[ ]decrease 2.[ ]no change 3.[ ]up 1-10% 4.[ ]up 11-50% 5.[ ]up 51-100% 6.[ ]up 101-200% 7.[ ]up 201-500% 8.[ ]up over 500%	1.[ ]increase 2.[ ]no change 3.[ ]down 1-10% 4.[ ]down 11-25% 5.[ ]down 26-50% 6.[ ]down 51-75% 7.[ ]down 76-100%	1.[ ]decrease 2.[ ]no change 3.[ ]up 1-10% 4.[ ]up 11-50% 5.[ ]up 51-100% 6.[ ]up 101-200% 7.[ ]up 201-500% 8.[ ]up over 500%	1.[ ] Improved 2.[ ] No Change 3.[ ] Somewhat Restricted 4.[ ] Highly Restricted	[ ] No [ ] Yes

(Continued)

III. Insurance Program--Please indicate for each coverage below the market conditions you have found during your most recent renewal.

(1) Coverage	(2) Availability	(3) Premium Change	(4) Limit Change	(5) Deductible/ Retention/SIR Change	(6) Coverage Conditions	(7) Are you interested in exploring coverage in a group solution?
G. Pollution/ Environmental ( ) Included in A. Current limits $ ______ Last renewed date ______ mo/yr	1.( ) Easy to Purchase 2.( ) Some Difficulty 3.( ) Much Difficulty 4.( ) Unavailable 5.( ) Not renewed by carrier 6.( ) Cancellation since 7/1/84 7.( ) Did not purchase	1.( )decrease 2.( )no change 3.( )up 1-10% 4.( )up 11-50% 5.( )up 51-100% 6.( )up 101-200% 7.( )up 201-500% 8.( )up over 500%	1.( )increase 2.( )no change 3.( )down 1-10% 4.( )down 11-25% 5.( )down 26-50% 6.( )down 51-75% 7.( )down 76-100%	1.( )decrease 2.( )no change 3.( )up 1-10% 4.( )up 11-50% 5.( )up 51-100% 6.( )up 101-200% 7.( )up 201-500% 8.( )up over 500%	1.( ) Improved 2.( ) No Change 3.( ) Somewhat Restricted 4.( ) Highly Restricted	( ) No ( ) Yes
H. Aviation Fleet Liability ( ) Included in A. Current limits $ ______ Last renewed date ______ mo/yr	1.( ) Easy to Purchase 2.( ) Some Difficulty 3.( ) Much Difficulty 4.( ) Unavailable 5.( ) Not renewed by carrier 6.( ) Cancellation since 7/1/84 7.( ) Did not purchase	1.( )decrease 2.( )no change 3.( )up 1-10% 4.( )up 11-50% 5.( )up 51-100% 6.( )up 101-200% 7.( )up 201-500% 8.( )up over 500%	1.( )increase 2.( )no change 3.( )down 1-10% 4.( )down 11-25% 5.( )down 26-50% 6.( )down 51-75% 7.( )down 76-100%	1.( )decrease 2.( )no change 3.( )up 1-10% 4.( )up 11-50% 5.( )up 51-100% 6.( )up 101-200% 7.( )up 201-500% 8.( )up over 500%	1.( ) Improved 2.( ) No Change 3.( ) Somewhat Restricted 4.( ) Highly Restricted	( ) No ( ) Yes
I. Other Liability (please specify) ______ Current limits $ ______ Last renewed date ______ mo/yr	1.( ) Easy to Purchase 2.( ) Some Difficulty 3.( ) Much Difficulty 4.( ) Unavailable 5.( ) Not renewed by carrier 6.( ) Cancellation since 7/1/84 7.( ) Did not purchase	1.( )decrease 2.( )no change 3.( )up 1-10% 4.( )up 11-50% 5.( )up 51-100% 6.( )up 101-200% 7.( )up 201-500% 8.( )up over 500%	1.( )increase 2.( )no change 3.( )down 1-10% 4.( )down 11-25% 5.( )down 26-50% 6.( )down 51-75% 7.( )down 76-100%	1.( )decrease 2.( )no change 3.( )up 1-10% 4.( )up 11-50% 5.( )up 51-100% 6.( )up 101-200% 7.( )up 201-500% 8.( )up over 500%	1.( ) Improved 2.( ) No Change 3.( ) Somewhat Restricted 4.( ) Highly Restricted	( ) No ( ) Yes

(Continued)

III. Insurance Program--Please indicate for each coverage below the market conditions you have found during your most recent renewal.

(1) Coverage	(2) Availability	(3) Premium Change	(4) Limit Change	(5) Deductible/ Retention/SIR Change	(6) Coverage Conditions	(7) Are you interested in exploring coverage in a group solution?
J. Banker's Blanket Bond Current limit: $______ Last renewed date ______ mo/yr	1.[ ] Easy to Purchase 2.[ ] Some Difficulty 3.[ ] Much Difficulty 4.[ ] Unavailable 5.[ ] Not renewed by carrier 6.[ ] Cancellation since 7/1/84 7.[ ] Did not purchase	1.[ ]decrease 2.[ ]no change 3.[ ]up 1-10% 4.[ ]up 11-50% 5.[ ]up 51-100% 6.[ ]up 101-200% 7.[ ]up 201-500% 8.[ ]up over 500%	1.[ ]increase 2.[ ]no change 3.[ ]down 1-10% 4.[ ]down 11-25% 5.[ ]down 26-50% 6.[ ]down 51-75% 7.[ ]down 76-100%	1.[ ]decrease 2.[ ]no change 3.[ ]up 1-10% 4.[ ]up 11-50% 5.[ ]up 51-100% 6.[ ]up 101-200% 7.[ ]up 201-500% 8.[ ]up over 500%	1.[ ] improved 2.[ ] No Change 3.[ ] Somewhat Restricted 4.[ ] Highly Restricted	[ ] No [ ] Yes
K. Property Damage/ Business Interruption Current limit: $______ last renewed date ______ mo/yr	1.[ ] Easy to Purchase 2.[ ] Some Difficulty 3.[ ] Much Difficulty 4.[ ] Unavailable 5.[ ] Not renewed by carrier 6.[ ] Cancellation since 7/1/84 7.[ ] Did not purchase	1.[ ]decrease 2.[ ]no change 3.[ ]up 1-10% 4.[ ]up 11-50% 5.[ ]up 51-100% 6.[ ]up 101-200% 7.[ ]up 201-500% 8.[ ]up over 500%	1.[ ]increase 2.[ ]no change 3.[ ]down 1-10% 4.[ ]down 11-25% 5.[ ]down 26-50% 6.[ ]down 51-75% 7.[ ]down 76-100%	1.[ ]decrease 2.[ ]no change 3.[ ]up 1-10% 4.[ ]up 11-50% 5.[ ]up 51-100% 6.[ ]up 101-200% 7.[ ]up 201-500% 8.[ ]up over 500%	1.[ ] Improved 2.[ ] No Change 3.[ ] Somewhat Restricted 4.[ ] Highly Restricted	[ ] No [ ] Yes
L. Flood/Earthquake Current limit: $______ Last renewed date ______ mo/yr	1.[ ] Easy to Purchase 2.[ ] Some Difficulty 3.[ ] Much Difficulty 4.[ ] Unavailable 5.[ ] Not renewed by carrier 6.[ ] Cancellation since 7/1/84 7.[ ] Did not purchase	1.[ ]decrease 2.[ ]no change 3.[ ]up 1-10% 4.[ ]up 11-50% 5.[ ]up 51-100% 6.[ ]up 101-200% 7.[ ]up 201-500% 8.[ ]up over 500%	1.[ ]increase 2.[ ]no change 3.[ ]down 1-10% 4.[ ]down 11-25% 5.[ ]down 26-50% 6.[ ]down 51-75% 7.[ ]down 76-100%	1.[ ]decrease 2.[ ]no change 3.[ ]up 1-10% 4.[ ]up 11-50% 5.[ ]up 51-100% 6.[ ]up 101-200% 7.[ ]up 201-500% 8.[ ]up over 500%	1.[ ] Improved 2.[ ] No Change 3.[ ] Somewhat Restricted 4.[ ] Highly Restricted	[ ] No [ ] Yes

(Continued)

III. Insurance Program -Please indicate for the coverage below the market conditions you have found during your most recent renewal.

(1) Coverage	(2) Availability	(3) Premium Change	(4) Limit Change	(5) Deductible/Retention/SIR Change	(6) Coverage Conditions	(7) Are you interested in exploring coverage in a group solution?
M. Other Property (Please specify) ______	1.( ) Easy to Purchase	1.( )decrease	1.( )increase	1.( )decrease	1.( ) Improved	( ) No
	2.( ) Some Difficulty	2.( )no change	2.( )no change	2.( )no change	2.( ) No Change	
	3.( ) Much Difficulty	3.( )up 1-10%	3.( )down 1-10%	3.( )up 1-10%	3.( ) Somewhat Restricted	( ) Yes
	4.( ) Unavailable	4.( )up 11-50%	4.( )down 11-25%	4.( )up 11-50%		
Current limits $ ______	5.( ) Not renewed by carrier	5.( )up 51-100%	5.( )down 26-50%	5.( )up 51-100%	4.( ) Highly Restricted	
		6.( )up 101-200%	6.( )down 51-75%	6.( )up 101-200%		
Last renewed date ______ mo/yr	6.( ) Cancellation since 7/1/84	7.( )up 201-500%	7.( )down 76-100%	7.( )up 201-500%		
		8.( )up over 500%		8.( )up over 500%		
	7.( ) Did not purchase					

IV. Miscellaneous Questions:

A. Of the coverages listed below, please indicate which ones posed severe problems in 1986. This would include cancellation, complete unavailability, or severe changes in premium, limit, or deductible/SIR/retention.

( ) bumbershoot marine
( ) inland marine/transit
( ) ocean marine cargo
( ) boiler and machinery
( ) war risk
( ) excess workers' compensation
( ) personal injury
( ) hull
( ) fidelity
( ) fiduciary liability
( ) crime
( ) other (please specify) ______

B. Have you been forced to accept claims-made coverage as a condition to obtaining a general liability insurance policy?

Primary: ( ) Yes ( ) No

Excess: ( ) Yes ( ) No

C. Have you been forced to curtail or change your business operations because you could not obtain reasonable insurance coverage? If "yes", please elaborate in the "Additional Comments" section below.

( ) Yes ( ) No

Additional Comments: ______

______

V. Alternative Risk Financing Facilities

We are interested in contacting captives, pools and other alternative risk financing facilities to help assess whether they are available to provide coverage. If you are aware of any captives, pools, or other kinds of alternative facilities, which now exist or are forming, please provide contact information below:

A. Name of facility: ________________

Contact person: ________________

Title: ________________

Contact organization: ________________

Address: ________________

Phone number ( ) ________________

B. Name of facility: ________________

Contact person: ________________

Title: ________________

Contact organization: ________________

Address: ________________

Phone number ( ) ________________

C. Name of facility: ________________

Contact person: ________________

Title: ________________

Contact organization: ________________

Address: ________________

Phone number ( ) ________________

If you have any questions, please contact:

Ms. Anita Benedetti, ARM
Director of Research & Education
Risk & Insurance Management Society, Inc.
205 East 42nd Street
New York, NY 10017
(212) 286-9292

Mr. FLORIO. Thank you very much.

To what degree are any of your constituent organizations thinking seriously or doing anything about self-insurance, risk retention organizations, industrywide consortiums for self-insurance? Is this something that is actively being pursued?

Mr. HEYDINGER. Very much so. In a lot of industries, in a lot of our members, it is really the only choice they have. That is spurring it.

The interest to reduce costs. And more importantly, I think the interest not to become dependent on that industry that is going to jerk you around every few years, there is a big emphasis for that.

Mr. FLORIO. Well, why would not the same problems that the insurance industry testified about in previous hearings, the same problems we heard about today, which are the problems that caused the industrys problem according to the industry, why would those same problems not be ones that would be visited upon these new mechanisms for providing insurance? Liability judgments, things of that sort.

Mr. HEYDINGER. Right. Well, Mr. Chairman, that is an excellent question, because they will. I mean, we are really stepping into the shoes of the insurance industry. And I have to point out, we are doing it somewhat reluctantly.

I know I have gone to my own management and asked for millions of dollars in the last few months to contribute to some of these self-help groups. And I have been quick to point to them that, you know, we are really becoming risk bearers here, and that we face these same things. And the influence of the tort system certainly is going to be directly imposed, whereas maybe it was indirectly before, upon us.

I would hope that the reason that we can convince our managements to do this is that we are trying to learn the lessons from the industry. We are trying to come up with that discipline, trying to come up with agreements and contractual relationships that say what they mean and would hold up in the court's eye. But quite honestly, it is scary. I mean, it is new.

Mr. FLORIO. Might it be that, particularly in light of some of the discussions that we had with the previous panel, that the expertise that would be contained in Hallmark, in terms of assessing its risks growing out of the uniqueness of your business, whatever the unique risks are of your business, might be able to be better judged by underwriters in a risk retention group or self-insurance mechanism that you would part of, better than a more generalized insurance company effort that may not have the specialized risk analysis capability that you do in-house? Is that a legitimate——

Mr. HEYDINGER. I think it is a valid point. I think what is going to make them work in the short term is that we are not doing these things to get cheaper insurance. Because the couple that we have participated in, we find out that when the underwriters do their thing—and they know more about us than the commercial industry does normally—that the rates are very significant.

The real test of these organizations is going to be, if the soft time ever returns again, have they got them structured so that they do not fall into some of the underpricing traps that the industry has.

Mr. FLORIO. Let me just ask a specific question about an area. The statement that you have submitted indicates that—there is a statement, rather to EPA, that your organization submitted, putting in question whether the courts in environmental matters have gone to liberal extremes on the question of pollution coverage. And you have characterized the absolute pollution exclusion in the ISO form as a classic case of overreaction.

Can you elaborate on your opinion that somehow it has not been wild judicial decisions that are the cause of the environmental problem?

Mr. HEYDINGER. Well, we are saying that there are two types of environmental exposures. There is the long-term gradual exposure, and that has been measured by EPA at a number in the billions that exceeds the capital and surplus position of the whole insurance industry.

We would agree as buyers, that probably is not the insurance industry's role to assume today the ills of 30 or 40 years. But all of us have these exposures to that sudden and accidental accident that could take place.

I mean, you cannot have a little scientific lab with some of these glass vials without the exposure of something dropping on the floor and getting into a drain and causing you an environmental problem. And that is the part of the exposure that we think that the industry, rather than walk away from, can really measure and examine, and write a policy and set effective rates.

Mr. FLORIO. Mr. Slattery.

Mr. SLATTERY. Mr. Heydinger, well, I really appreciate your testimony today. And I do not know that I have any specific questions for you other than to commend you for what I think was a pretty well balanced approach to this problem, recognizing that there is sufficient blame probably to go around.

The insurance industry has some responsibility to bear in this area, as do Government decisionmakers, certainly at the State level and probably at the Federal level with respect to what we do with tax law and fiscal policy and other things that affect the insurance industry.

So I appreciate your testimony.

Mr. HEYDINGER. Thank you.

Mr. SLATTERY. It was good to have you here.

Mr. FLORIO. Let me just raise two last points.

First of all, express my appreciation for your detailed analysis in your statement in raising points of concern that you have about the claims-made form. You went into detail on a number of very crucial policy questions, and that is very helpful to us.

The last question I would like to ask is, to what degree are you concerned about insolvencies in the insurance industry and the prevalence of so many problems in problem companies as was testified to by the previous panel, and the apparent absence of some sort of a safety net system across the country?

Mr. HEYDINGER. Well, I am greatly concerned, I guess would be the briefest answer. We are obviously not as close to those carriers and that industry as the previous panel, so we rely a great deal on them and others, statistical review firms and that. And that is our

best source of information, and we have to react to what we believe.

So it is very difficult to be picky though when you have got a very contracted marketplace. I mean, we are dealing with carriers that are on those early warning lists, and trying to stay in tune with some of these previous panelists to get some early signals of whether that continues to make sense.

But, you know, you have to take what is out there. So we are greatly concerned, because at the end of the day, you know, that is when that contract comes into play is when the claim comes home.

Mr. FLORIO. Let me just say that this aspect of this whole question, this question of insolvencies, the question of the fragility of the whole industry has come as a great surprise to me as a result of spending the last 4 months going into depth. I do not think there is any mass appreciation out there as to the existence of that problem.

And to this point, nobody has legislated away the business cycle. And therefore, the presumption being that at some point, if there is a downturn, you are going to be talking about a lot of insurance industry participants going under with no mechanism around.

We have talked a lot publicly about the banking problems. I think there is a general awareness of the problems associated with the banking industry. But I do not even think there is a general awareness of the problem that is associated with the insurance industry that the insurance regulators know about, some who read trade journals may know about, but I do not think the American people know about.

And it seems to me almost inevitable that the next business downturn, you are going to have a great shaking out process in this industry, which is going to be very disruptive.

Mr. HEYDINGER. Generally, the amounts available in those guarantee funds would not be sufficient for the large commercial consumers to afford any kind of protection. Normally, we carry deductibles in the level of the limits that are available there.

Mr. FLORIO. Let me express my appreciation to you for your participation and thank you very much.

Mr. HEYDINGER. Thank you.

Mr. FLORIO. If there is no further business to come before the committee, the committee stands adjourned.

[Whereupon, at 1:10 p.m., the subcommittee meeting was adjourned, to reconvene at the call of the Chair.]

[The following letters and statement were submitted for the record:]

NATIONAL ASSOCIATION of
CASUALTY & SURETY AGENTS

Government Affairs Office
600 Pennsylvania Avenue S E
Suite 211
Washington, D C 20003
(202) 547-6616

February 14, 1986

The Honorable James J. Florio
Chairman
Subcommittee on Commerce, Transportation
and Tourism
U. S. House of Represantatives
2322 Rayburn House Office Building
Washington, D.C. 20515

Dear Mr. Florio:

The National Association of Casualty and Surety Agents (NACSA), a trade association representing some 300 of the nation's leading commercial property/casualty insurance agencies and brokerage firms, shares your interest in the current market problems confronting the property/casualty insurance industry. Availability and affordability of business insurance has become a serious concern, nationwide It is certainly an issue which we as an industry cannot ignore. Rather, NACSA believes we must face our problems and their solutions head on.

NACSA views this market crisis from many differant angles. It is complex endmulti-feceted. As there is no one cause, there will be no one solution. Some solutions will be found in the short-term, but the major solution to the liability insurance problam in our view - tort reform - will only come over the long-term since reforms of our civil justice system have historically taken a substantial amount of time to enact.

NACSA, as you know, is commited to the free enterprise system and to state regulation of insurance. We want in place a fair and equitable insurance system which can operate at a profit for the majority of consumers, business or otherwise, who are in need of the financial protection that insurance can provide. We believe that our private sector system has over the years served our nation well, but lately, a few cracks in its foundation have surfaced, and they have weakened its ability to provide enough capacity to meet consumer demand at affordable prices.

In the short-term, state regulatory reforms, coupled with the financial recovery of many insurers and their reinsurers, will resolve many of our market problems. However, some long-tail and long-latency disease exposures will not receive relief without tort reform.

In the interest of not wanting to repeat comments already submitted to your Committee, I would like to close by attaching a bullet summary of NACSA's view of the insurance problem. the outline addresses both its causes and its solutions. As you can see, what we are dealing with is a complicated problem; consequently, no "quick fix" solutions will result in a cure.

NACSA would appreciate your making this letter and its attachment a part of the formal hearing record of this Committee. We would like to continue to be of assistance to you and your Committee as you continue to examine this issue.

Sincerely yours,

Joan Albert Dreux

Joan Albert Dreux
Executive Director
Government Affairs

NATIONAL ASSOCIATION of
CASUALTY & SURETY AGENTS
Government Affairs Office
600 Pennsylvania Avenue S E
Suite 211
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UNDERSTANDING THE CURRENT LIABILITY INSURANCE CRISIS -
ITS ROOTS AND ITS RESOLUTION

JOAN ALBERT DREUX
EXECUTIVE DIRECTOR
GOVERNMENT AFFAIRS

Summary of Some of the Root Causes of the Current Liability Insurance Crisis

- A civil justice system which is out of control, creating an inability to determine actuarially sound pricing or to reasonably predict loss
- Overall operating loss in the Property/Casualty (P/C) industry of $3.8 billion in 1984 and an estimated operating loss of $5.5 billion for 1985 (These figures do not take into account tax refunds or capital gains. For example, in 1984, the industry had a nominal gain of a $1.5 billion profit after taxes, equalling less than 3% return on equity.)
- The last five years of P/C industry's cash-flow underwriting practices
- Unexpected retroactive liabilities created mainly by federal laws, i e , CERCLA, RCRA, the Motor Carrier Act of 1980, etc , forcing the P/C industry to pay claims on risks for which no premiums were collected
- Major losses experienced by reinsurers causing drastic reductions in reinsurance availability, putting further strain on insurer capacity
- Reduced insurer surplus due to unexpected losses in investment income and high awards from unexpected losses

Summary of Possible Short-term Solutions

- Cost-based underwriting
- Short-term restrictions on underwriting of most business insurance to enable financially troubled insurers to recover from cash-flow cycle and to regain their financial strength by replenishing their reserves and surplus
- Market Assistance Programs (MAPs) for liability lines other than those considered to be uninsurable, i e., asbestos abatement contractors' liability and pollution liability
- Use of NAIC approved claims-made versus occurrence forms for long-tail, high risk exposures due to the unresolved problems of the current tort system
- Enactment at the state level of reasonable state regulations for mid-term cancellations, mid-term premium hikes, renewals, prior approval of rates, and blanket, uniform withdrawals from full lines of business, i e , day care centers, municipal liability, nurse mid-wives, etc.

February, 1986

(OVER)

Summary of Possible Long-term Solutions

- Reform of the civil justice system, i e
  - caps on non-economic awards, i e , pain and suffering awards and punitive damages
  - limitations on "deep-pocket" liability standards such as strict, and joint and several liability
  - incentives for settlements and structured awards
  - parameters placed on municipal liability, including but not limited to a redefining of sovereign immunity standards
  - limitations placed on attorneys' contingency fees
  - clearer lines established between actual causation and responsibility resulting from a need to get a handle on who is responsible for long latency exposure and for how much
  - enactment of a federal product liability tort reform statute

Summary of What are Not Long-term Solutions

- Forcing insurer participation in insurance mechanisms such as Joint Underwriting Associations (JUAs) because they only mask the problems instead of addressing the causes
- Establishing assigned risk pools for they again only mask the problems by dealing with the immediate availability problems but do not address the cause nor do they encourage loss prevention by insureds
- Over regulation of insurers, i.e.:
  - mandating rates or capping premiums
  - restrictive reinsurance regulations
  - making insurers operate as a public utility
- Repeal of the McCarran-Ferguson Act, the insurance industry's federal antitrust exemption
- Federal Regulation of insurer marketing practices and ratemaking

For further information contact Joan Albert Dreux, Executive Director, Government Affairs

February, 1986

COPPUS ENGINEERING CORPORATION

P O BOX 457 WORCESTER MA 01613 USA TEL 617/756 8391 TELEX 920424

DONALD E HARE, PRESIDENT

January 3, 1986

Congressman Joseph D. Early
34 Mechanic Street
Worcester, Massachusetts 01608

Dear Joe:

Although I believe we are one of the larger corporate constituents in your district and regrettably one of a dwindling number of old line "smoke-stack industry" hard goods manufacturers, I think you will agree it is only in very rare instances we seek your assistance or communicate on key issues — perhaps to our mutual detriment. Hopefully the restraint we have exercised in the past will lend greater credence to our pleas and make our present call for help better heard.

At the moment, we have a huge problem facing us and our peers, both large and small. To give it a relative ranking, if a typical problem on which we might seek assistance was graded on a scale from 1 to 10, it probably would deserve a 2 or 3 rating; the issue - or crisis - at hand deserves a 9 or 10! Here we are referring to the problem of costs and availability of liability insurance coverage.

Although you might quickly react with a "why concern me about insurance and claim issues?" as being not in the national legislative province, the crisis and the impact on Coppus and virtually every other manufacturer in your district is so monumental that it is unquestionably a national issue. Why? Because it translates into jobs, into profits (tax revenues), and into investment levels (future tax revenues). For Coppus, this year the increased cost of product liability insurance coverage is going to mean we can employ 10 to 12 fewer employees. Not in order to increase our profits, nor because our sales are declining (they're not), but in order to stay even while our product liability insurance costs skyrocket!

Based on present estimates (we can't even obtain firm quotes yet), our premium for our insurance year from February 1, 1986 to January 31, 1987 will (for less coverage and with a higher deductible) rise from $102,000 in 1984 to $217,000 in 1985 to an estimated $700,000 in 1986.

Congressman Joseph D. Early
January 3, 1986 Page Two

So that we don't give you an inaccurate snapshot of the situation, here is a table of our coverage and premiums

Year	Coverage	Premium
1982	$15,500,000	$ 69,000
1983	$15,500,000	$ 55,000
1984	$20,500,000	$102,000
1985	$20,500,000	$217,000
1986	$21,000,000	$700,000 (est.)

An obvious question at this point is what has been the nature of our claims history? We think it has been very good. Admittedly, Coppus' carriers have incurred costs and had to defend claims and make settlements. In fact, Coppus has had nine claims since 1968 demanding a total of $17,874,000(!). Five of these claims have been settled for a total of $219,000 and four remain open. We think we have strong defenses related to the four remaining.

You might also ask, are we "buying right". We are buying coverage through the largest insurance brokerage firm in the world, who we feel has done an exemplary job in placing our account with suitable carriers. We don't believe real opportunity presently is available to us at substantially lower costs from appropriate carriers.

To provide you and your staff some background on the issues, I have also enclosed some material received currently from Associated Industries of Massachusetts and the National Electrical Manufacturers Association (our national trade association).

What do I think you can do?

First, I think national legislation limiting the time for filing a claim after the manufacture (or first sale) of the allegedly defective item or the provision of defective services or the taking of action allegedly causing harm must be instituted. A reasonable time frame would be two to three years or, at a maximum, five years. Not over 50 years as the courts have allowed in at least one case.

Second, I think legislation should prohibit damage claims related to equipment altered without the manufacturers' authorization and/or used in violation of manufacturers' warnings or instructions provided at the time of sale.

Third, I think legislation should limit the fees collectible by attorneys in damage cases to some reasonable percentage and to prohibit contingency fees. The Wall Street Journal reported the other day that the legal fees in the Johns-Manville asbestos cases were estimated to be $1 billion. This is obviously $1 billion not going to the aggrieved, never mind the logic that says that we should penalize someone for his acts which later, and only later, are determined to be damaging.

Fourth, we believe a realistic but finite legislated cap limiting the amount payable in both death cases and for "pain and suffering" has become a necessity.

There is no question in my mind that a large part of the problem emanates from a general public attitude currently supported by our judicial system that permits the filing of huge claims, the processing of them at tremendous effort and expense and the levying of monumental judgments -- in many cases against those marginally responsible (if at all) on a "they can afford to pay" basis. The cruel truth is the situation has gotten out of hand and we all are going to pay too much one way or another. Ultimately, the correction must come from a change in public attitudes but, in the meantime, we desperately need some limits on the system. This is where you and your colleagues can help.

Sincerely,

LAW OFFICES

DEANE, SNOWDON, SHUTLER & GHERARDI

1607 NEW HAMPSHIRE AVENUE N W

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BENJAMIN R JACKSON P C
CONSULTANT

February 20, 1986

Mr. Paul Joffe, Esq.
Legislative Counsel
Subcommittee on Commerce,
Transportation and Tourism
151 House Office Building
Annex #2
Washington, D.C. 20515

Dear Mr. Joffe:

I am writing and submitting comments on behalf of the Coalition of Automotive Associations (CAA), to be included as part of the record of the hearing held by this Committee on February 20, 1986, concerning the cost and availability of liability insurance. CAA is a trade association comprised of over 2,100 small businesses which manufacture and distribute aftermarket parts and accessories for motor vehicles.

It is an undisputable fact that there is a current problem in the marketplace in finding affordable liability insurance - if such insurance still exists. The problem has quickly evolved into a crisis which is affecting numerous industries and professions. Unfortunately, small businesses seem to have been hit the hardest. Over the past two years, many of our members have found that product liability insurance, at any price, was wholly unavailable to them and they have been forced to continue in business without the insurance protection which is essential to provide for the reasonable recovery of legitimate consumer claims. Still more of our members have found that the levels of insurance available to them have decreased from $10 million, to $5 million, to $1 million, and now, $300,000 in aggregate claims. Even though insurance is available to them, the levels are such as to render the insurance essentially meaningless. For those who are offered coverage in amounts approaching $300,000, the premiums have increased to $25,000 to $50,000 per year where they had been previously averaging $2,000 to $5,000 per year for

DEANE, SNOWDON, SHUTLER & GHERARDI

Mr. Paul Joffe, Esq.
February 20, 1986
Page Two

$5 million in product liability coverage. The remaining few of our members who have been successful in retaining reasonable limits of liability coverage have experienced increases in premiums of 300 to 1,000 percent.

It appears that there are several factors which have contributed to the current situation, such as the descent from high interest rates of recent years, the withdrawal of national re-insurance groups outside of the United States, and the general litigious character of American society. While it is not precisely clear how to remedy the situation, it is obvious that something has to be done. The impact on the business community has been devastating. Companies have been driven out of business, prices of consumer products have sharply increased and injured consumers with legitimate claims are frequently finding that those who might be liable have no capability of compensating them for their losses due to their limited assets and lack of insurance coverage.

A part of the solution for dealing with this exploding crisis is to provide a tort liability system which has more predictability and certainty than what currently exists. Historically, obtaining liability insurance was a relatively simple task since liability claims could be accurately projected based on past experience, which provided a predictable basis upon which to establish premiums. This was capable of being done because it was known that the standard for liability would be based on negligence. Although negligence was defined by state law, and there obviously were some differences among the various state laws, the rules for defining what would constitute negligence and the consequences of that negligence were reasonably ascertainable in a given state. Within the last couple of decades, however, there have been creative new theories under which compensation has been awarded to injured plaintiffs. Courts today appear to be placing more emphasis on the relative ability of plaintiff and defendant to absorb the consequences of defendant's activity than on the defendant's culpability. This is apparent with the increased use of the doctrine of strict liability. This evolution of the tort system was accompanied by a dramatic increase in litigation, including large awards for punitive damages and for non-economic losses. CAA strongly supports the action taken by the members of the Senate Committee on Commerce, Science and Transportation in the area of product liability reform. Their proposed uniform federal product liability law will hopefully restore the predictability and certainty of tort liability to allow small business to once again obtain affordable and adequate insurance coverage. We request that members of this Committee support similar legislation which may be proposed in the House.

We applaud this Committee for addressing the problem of the cost and availability of liability insurance and request that the members take action to effectively remedy the situation. We appreciate having the opportunity to comment and look forward to Committee action addressing the serious problem which has arisen in the insurance market and detrimentally effected the entire business community.

Sincerely,

John Russell Deane III

JOHN RUSSELL DEANE III

STATEMENT BY

WILLIAM M. QUINN

AMERICAN SUPPLY ASSOCIATION

Mr. Chairman: My name is William M. Quinn of Memphis, Tennessee. I am President of General Pipe and Supply Company and Chairman of the Government Affairs Council of the American Supply Association. ASA is the national trade organization for the plumbing-heating-cooling-piping industry, most of which are small, family-run businesses.

As a plumbing-heating-cooling-piping wholesaler and officer in my national association, I have had considerable discussion with business associates and fellow wholesalers on the alarming increases in insurance premiums and reductions in insurance coverage that have occurred nation-wide. We can provide a vast body of anecdotal information on businesses that have experienced huge increases in liability insurance premiums, that have been denied coverage or face termination of their policies, that have been forced to self-insure and thereby jeopardize assets that have been accumulated over several family generations, or that will simply go-out-of-business rather than face continued risk or depletion of their businesses. We are confident that the committee will receive these kind of examples from the witnesses called before you today, not only from my own state of Tennessee but from throughout the nation. Stories of the calamity in insurance protection abound and plainly illustrate the crisis facing small businesses today.

For its part, ASA has attempted to gather data from throughout its membership and quantify those results in a manageable form. Our results come from over two hundred wholesale businesses located throughout the 50 states. The response from our members confirms what we have heard indivi-

dually and duplicates the experience of many other hard-pressed industries. The results can be summarized as follows: a large majority of ASA members indicated that they were experiencing substantial increases in premiums in

Commercial auto and truck insurance................86.3%

Property and casualty insurance....................78.8%

Product liability insurance........................76.9%

Further, for officers and directors liability insurance (which only applied to 40% of the responding companies, due to the nature and size of our businesses), 61.5% of our respondents experienced increases. The median increase in premiums for all types of coverage was 50%.

In recent years, we have taken a particularly close look at product liability coverage, a problem which is illustrative of trends throughout the insurance industry. As wholesalers, we are product sellers rather than manufacturers. In most instances, we function as a distributor, in the truest sense of the word. We have little to do with the product beyond transportation, storage and sale. Only under unusual circumstances do we become involved in any transformation or assemblage of a product during the period that it is in our control. Yet we are being sued, and less frequently held financially accountable, for harm that has resulted from the use of that product. This we attribute to our legal system, which employs a Robin Hood mentality to compensating victims. The logical progression

and application of product liability to our industry was recently noted by John McDonald of the Brock-McVey Company of Louisville, ASA's former President and Chairman of the Board. McDonald notes insurance industry statistics that most accidents occur in close proximity of the home. Of these, the vast majority of injuries occur in the bathroom, where, in turn, a vast majority occur in the shower or tub. In this illustration, McDonald is being somewhat facetious, but only to a point and his conclusion has an increasingly ominous ring to our members. In a no-fault legal environment where plaintiffs and juries look to the availability of funds for a judgment -- the so-called "deep pocket" -- plumbing-heating-cooling-piping wholesalers can expect increased exposure and a continuing upward spiral to premiums. Manufacturers, wholesalers and contractors know that, irrespective of provision for safety devices, a danger that has been known to man for centuries -- getting in and out of the tub -- can become the legal cause of action that drives our members out of business in the 1980s.

In our survey, plumbing-heating-cooling-piping wholesalers first point to the symptons -- higher premiums -- but time after time mention the root cause of the problem to be the legal system. It is this problem that we seek to address: reform of the tort system. We well understand that there are elements of this task that appropriately should be assumed at the state-level. However, this is a national problem that spans states' boundaries and permeates all of interstate commerce. It is a national small business issue, a commerce issue, a judicial issue and an economic issue.

We urge your committee to move past the symptons of this crisis -- which we join other national organizations in reaffirming as exactly that, a crisis -- and take a comprehensive look at how Congress can appropriately reform the tort system. We will have specific recommendations as you move ahead with your deliberations and look forward to working with you towards a solution.

Our survey results follow and, with the permission of the Committee, are incorporated in our testimony.

LIABILITY INSURANCE SURVEY

1. Has your company experienced substantial premium increases with your liability insurance coverage?

   a. commercial auto and truck liability:

   yes 86.3% no 13.7%

   % increase 50%

   b. officers and directors liability:

   yes 25.5% no 13.6% does not apply 60.7%

   % increase 50%

   c. property and casualty:

   yes 78.8% no 20.1%

   % increase 50%

   d. pollution liability:

   yes 1.7% no 6.8% does not apply 92.1%

   % increase ____

   e. product liability:

   yes 76.9% no 23.1%

   % increase 50%

   f. other: ______________________________

2. Do you consider product liability to be a problem for your company?

   yes 55.7% no 44.3%

   If yes, how serious is the problem?

   extremely 27.8% very 28.7% somewhat 43.3%

   Why? ______________________________

3. What are your present liability insurance limits? $ 2,000,000 (median)

Additional comments: ______________________________

Please Return To: American Supply Association
Government Affairs Office
1919 Pennsylvania Avenue, Suite 300
Washington, D.C. 20006

2. Do you consider product liability to be a problem for your company? Why?

- Claims on the increase
- Court judgments must be capped - attorney's fees must not be contingent on judgement
- We have very little control/we should have more.
- Being a division of a Fortune 500 Company, we are considered having deep pockets. Many suppliers do not have adequate coverage.
- We have been named in suits for things we have no control over.
- It's passed on to manufacturers - but our insurance cancels.
- Potential financial liability.
- High premiums; thin to non-existent product markets; unpredictable legal environment.
- We get sued along with the contractor who installed job and the manufacturer. This is happening everytime a modest amount of damage is done by a poor installation in the field. Attorneys are having a field day!
- As a packager of valves and activators, we are caught "in-between" the two principal manufacturers. Due to rising costs, we were forced to reduce coverage by 1/2 this 1986; i.e., from $3 million to $1.5 million
- Never sure of some potential uncovered liability
- We are named in lawsuits caused by our vendor's goods.
- We sell products that can be dangerous if misused or mishandled.
- We do not install but in a lawsuit we would probably be sued.
- Even though products are delivered in manufacturers cartons, any legal action includes distributor and therefore we must defend ourselves.
- Underwriting is disregarded and company raised premium just to raise the premium.

- Never know what the court will allow.
- Unfounded lawsuits.
- Lawyers
- Do not believe we should have to take it. We only serve as distributors.
- Defense costs.
- Too high, for a wholesaler is only the middleman.
- Ability to tender a manufacturer for defense.
- Possibly could find ourselves not being able to insure for the catastrophe and have our business lost through a suit.
- Litigation and documentation consume vast amounts of time - heavy research task.
- All these lawsuits and very costly settlements and legal fees.
- We are caught in the middle and our executive exposure keeps premiums high.
- Present philosophy in courts/Import Products
- With the size of the current awards - one suit which previously was minor could bankrupt us.
- We are small and a large award could wipe us out.
- The problem is simply the cost. We do not feel we have very much exposure but cannot afford to be without it.
- When a suit is filed, all are included, liable or not.
- Because we have not experienced any serious product liability claims.
- Public awareness increases risk. Problem not extreme because we represent quality manufacturers.

Additional Comments:

- We secured substantial premium savings in 1985 by getting bids on our coverage. However, we do expect substantial premium increases in 1986, even though we have filed no claims in 1985.
- Product liability suits have become the legal "out" for the "careless - inept - ignorant and greedy" product abuser.
- Could be one of ASA's greatest accomplishments if it could be instrumental in contributing to some control over this very serious insurance problem.
- Our extended use of printed disclaimers, on our invoices on warranties and liability, have greatly reduced our insurance problems. (At least according to our Insurance Company).
- Vehicular insurance is almost unaffordable to a small company with 15 or so units.
- Insurance costs are becoming too expensive to be practical.
- Taking competitive bids has kept our insurance costs pretty much under control.
- Totally agree that governmental action is a must as these costs make U.S. companies totally uncompetitive and seriously jeopardize profitability and corporate existance.
- All American manufacturers have product liability policies which relieves our responsibilities.
- All insurance costs going up! This time of year when policy becomes due is a bad time to have a survey - increase yet unknown and what to do about that anyway - insurance is practically uncontrollable! Switching carriers is about impossible especially at this time of carriers refusing to cover/quote, etc.
- We have noted substantial redefinition of limits and exclusions. Premium pay schedule has been accelerated.
- We expect some problems in cost and coverage with insurance. Presently we do not have a problem because we are on a 3-year package policy and it is not up for renewal until Spring 1987. This product liability issue is getting way out of hand. Something must be done.... We had one case in 1985 and it was settled out of court for a small amount (should be nothing) but the legal fees and all the lawyers involved were terrible.

- Being wholesale and distributor, it comes up rarely - hard to show negligence on our part.

- 1986 coverages will be adjusted to economic considerations including self-insurance.

- We have one suit (truck accident) pending now asking $16 million that we feel a few years ago would have been settled for under $25,000. This case will bankrupt one branch if not settled under $3 million.

- Rates should be controlled by legislation.

- Additional insurance was too expensive, plus our insurance is scheduled to go up again in 1986 by 40%.

- Congress needs to set a limit on the amount of awards by juries. Awards of millions of dollars are very unreasonable.

- We had to reduce our umbrella limits because of cost increases.

- It is imperative that we have legislation to base ceilings on claims and related costs - legal, medical - to bring down the 100% loss incurred by the insurance industry.

- There is no logic that we responsible for products which we do not change or alter.

- No product liability insurance on imported products.

- Anything that can be done to bring the costs back in line with reality will be appreciated. This situation may not get worse next year but, I have been told, it won't get any better.

- After paying premiums, you have to have your attorney argue with the insurance company's attorney to make them acknowledge the incident is in fact covered, and they have exposure. After settlement of damages (in our case) they shared, rather than paid, the damages. Additionally, you find yourself in an adversarial position with your manufacturer's insurance attorneys.

- I feel there are two problems, first there are too many lawyers and contingency fees should not be allowed.

- We are concerned about the "claims made form" recently adopted in Ohio on general liability insurance. Also the inclusion of legal fees as a part of the policy's claim limit.

- In the last 2 years, our insurance claims have increased 100%. We have gone from approximately $20,000 premiums in 1984 to $40,000 premiums for the upcoming 1986 year. It is getting ridiculous.

- Auto liability up largely due to new and additional vehicles - casualty and product liability up primarily due to the present tight market and not due to loss experience.

- Increase % based on most recent insurance renewal only. Liability increase is despite no loss experienced by insurance company.

- Will probably have difficulty purchasing adequate excess coverage this year. Will definitely pay increasingly exorbitant premiums.

- Our increase is far less than the industry, because of careful shopping for insurance and the expert guidance of an independent insurance counselor. I am well aware of others who have seen increases over 100%.

- Our insurance cost in 1986 will decrease significantly because we have taken the business from our local agent and given it to the captive agency for our hardware supplier (True Value).

- We have an umbrella coverage for any additional liability beyond our coverage limit.

- Premium for total "package"-business owner's policy increased 62.1%. In other words, product and property/casualty liability were included in total increase, and therefore didn't increase any more than fire, external coverage, burglary, etc.

LIABILITY INSURANCE AVAILABILITY

WEDNESDAY, MARCH 19, 1986

HOUSE OF REPRESENTATIVES,
COMMITTEE ON ENERGY AND COMMERCE,
SUBCOMMITTEE ON COMMERCE,
TRANSPORTATION, AND TOURISM,
Washington, DC.

The subcommittee met, pursuant to notice, at 9:40 a.m., in room 2123, Rayburn House Office Building, Hon. James J. Florio (chairman) presiding.

Mr. FLORIO. The subcommittee will kindly come to order.

Let me welcome all to this hearing, which is part of a series of hearings we have been conducting over the last number of months dealing with the insurance crises. When we say "the insurance crisis," really there is more than one crisis that we're dealing with. In the hearings before this subcommittee, we have heard testimony about the crisis in the courts. We have heard testimony about the crisis in insurance regulation and, of course, the economic crisis that is occurring as a result of the unaffordability and the unavailability of insurance.

Another facet of the problem is the crisis in risk abatement. In the early 1980's, the prevailing view in this community in Washington was to downplay the importance of health, safety, and environmental protection for the public. I think the story is fairly wellknown. Standards have been weakened and enforcement has not been what some of us think it should be.

Some who took this approach thought they were doing the business community a favor, but those who were supposed to benefit from this development, I think, today would have some questions as to whether they have benefited. Injured victims that public authorities were supposed to protect are finding their way into the courts, and the insurance industry is reeling from the consequences of widening ripples of risk and exposure.

This morning we're going to hear from a number of witnesses regarding areas in which the need for improved risk abatement is particularly acute. The trucking industry is a very good example. Truck safety is an ideal example.

An article in the current issue of the Journal of American Insurance, the magazine of the Alliance of American Insurers, tells the entire story. The article says that "with truck deregulation and the influx of new truckers, operators cut back on repairs and maintenance and disregard speed limits, safety laws, and rules on the hours that they could drive in any one day." At the same time,

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there was an abandonment of adequate enforcement of safety laws by the Federal Government.

The result, an 18-percent jump in truck accidents in 1983-84. When a spot check was done in my own State last summer, 25 percent of the large trucks inspected were ordered out of service, and in New York the figure was 50 percent.

The insurance article suggests that the problem may be even worse, but we are unsure because of what the journal calls a woefully understaffed Federal Safety Bureau.

The U.S. General Accounting Office has said that understaffing and underfunding have caused DOT to shortchange truck safety by failing to fine unsafe truck companies. Reportedly, DOT's so-called surprise inspections are announced in advance, resulting in massive avoidance by truckers warned almost immediately via the CB radio net.

The weakness of the Federal regulation of transport of hazardous materials that this committee has direct jurisdiction over has created extremely important concerns with States and even cities attempting to fill the void, but also creating thereby a maze of differing and confusing regulations.

With this record, it's no wonder that the insurance journal draws a direct connection between deregulation of safety requirements and pressure on the insurance system. One can go down the list of troubled lines of insurance and observe situations that are all too familiar and too similar to the trucking experience.

Fortunately, groups such as the American Trucking Association that is represented here today and many in the insurance industry recognize the problem and are calling upon the Government to reverse the costs of the last few years and put a stop to the abandonment of health and safety regulation enforcement.

Many other observers are also calling upon industry to give renewed emphasis to risk management itself.

It is obvious that there is no quick fix to deal with many of these problems that we have identified in the insurance industry. In subsequent hearings on insurance, this committee will consider various proposals to deal with various facets of the problem. For example, in April we will hold a hearing that will consider alternatives to traditional insurance, including bills to facilitate self-insurance groups by expanding the applicability of the Risk Retention Act.

As we proceed with these deliberations, however, we must be careful to keep in mind that the magnitude of the insurance crisis is one that is great, and we have to avoid the assumption that by addressing any one particular facet of the crisis, we will solve the other aspects of the problem.

I am grateful to the participants that we have here who will be testifying today, and at this point I would like to yield to the gentleman from New York, Mr. Lent.

Mr. LENT. Thank you, Mr. Chairman.

The testimony at the series of continuing hearings that we are having on the unavailability and unaffordability of liability insurance has shown that the causes of these problems are multiple, including overly competitive pricing of premiums by the insurance industry, joint and several liability, and high damage awards to name a few.

Solutions to these problems are being discussed at various levels. On Monday, an administration working group presented to the President recommendations for dealing with the problems facing the liability insurance market. In addition, many proposals have been suggested by the witnesses who have testified before this subcommittee.

The one thing that everyone seems to agree on is that the problems are extremely complex and that the solutions will take time. Time, however, is what those who cannot obtain or afford liability insurance through the traditional methods do not have. If they are not provided with alternatives to the traditional method of obtaining insurance, they may have to go without liability insurance and risk financial disaster should severe losses occur. They need an avenue for relief today. That is why yesterday I introduced the Liability Risk Retention Act of 1986.

This bill expands the Product Liability Risk Retention Act of 1981, which Chairman Florio and I cosponsored, to cover liability generally. My bill allows members of similarly situated groups to form their own insurance cooperatives across State lines. Members of these cooperatives will then be able to spread and assume all or a portion of their liability risks.

I realize that this legislation will not solve all the problems presently facing the liability insurance market, but it will provide a desperately needed alternative to the traditional methods of obtaining insurance. I am, of course, open to any suggestions to improve the bill and would be interested in any comments that any witnesses may have on expanding the Product Liability Risk Retention Act of 1981 to cover general liability.

Thank you, Mr. Chairman.

Mr. FLORIO. The gentleman from Louisiana.

Mr. TAUZIN. Thank you, Mr. Chairman.

Mr. Chairman, I realize that the insurance affordability and availability questions have just about reached crisis proportions several weeks ago when representatives of the AMA visited my office. AMA representatives have always been there to talk to me about how inappropriate it was for the Federal Government to regulate medical fees and medical charges. But the representatives that day were in my office to ask me if I would consider cosponsoring a bill to limit attorneys' fees because of the problems of insurance affordability and availability. That's when I realized things had really gotten out of hand.

Someone else also commented that perhaps we're going to get to the bottom of this problem the day that attorneys' malpractice insurance rates rise high enough that attorneys themselves realize that we've got a problem in terms of the overlitigious society we've created in the last several decades.

But the chairman has said it correctly. This is a many-faceted problem, not solved easily with tort reform nor easily with bills that might limit some of the players' ability to earn income and profit within the system. More importantly, it is an issue that does, in fact, relate to the manner in which we conduct business in our society and the manner in which we assume and abate the risk that is attendant to any business operation in a complex society.

So these hearings are critical and important in solving one more piece of that extremely complex riddle, and I commend the Chair for this continuing series of hearings.

Insurance is becoming the crisis issue of this decade. I think Time magazine, in its recent issue, focuses on the problem with a cover page story. It has developed rapidly, I think, within the last year, into one of almost crisis proportions.

Commendably, this committee, chaired by the gentleman from New Jersey, has been on the front of this issue before it has reached this proportion where national magazines have taken it up on page 1, and I think our continuing series of hearings may, in fact, give us some handle on this problem before we, perhaps, react incorrectly or overreact in some area. Rather these hearings will give us a chance to understand it in all its complexities and perhaps to make some wise decisions, particularly in this critical area of risk abatement.

I commend the Chair for these hearings. Thank you very much.

Mr. FLORIO. Thank you very much.

The gentleman from Pennsylvania.

Mr RITTER. Thank you, Mr. Chairman.

As has been mentioned earlier, this is the fourth of a series of hearings held by the subcommittee on the current liability insurance crisis, and I thank you for your leadership in bringing this subject to the fore.

The timing on the particular hearing couldn't have been better, in that just yesterday President Reagan was given an assessment of the situation and some ideas for addressing the crisis.

I'm sure I speak for the majority of my colleagues in saying that we on the subcommittee look forward to working with the administration in the coming months to try and tackle this thorny problem. Indeed, the insurance/insurability problem might well supersede budget and tax battles as the No. 1 legislative issue in the country. Clearly, by the term "crisis," the liability insurance situation must be addressed in an expeditious yet well-thought-out manner. The longer we wait, the more our economy suffers. Entrepreneurs, small businessmen, factory owners seeking to expand, the very lifeblood of future growth in employment are suffering, and when they suffer, all those seeking jobs suffer.

The crisis could lead to the hobbling of American industry, removing whole product lines from the shelves, and exporting the production of those products to foreign countries with the concomitant export of U.S. jobs. Whole segments of domestic service delivery could simply disappear.

We need not point fingers, however. We need to take what we learn at these and other hearings and direct it toward possible solutions which will remove potential obstacles to our economic growth.

With that in mind, I await with interest the testimony of today's witnesses.

Thank you, Mr. Chairman.

Mr. FLORIO. Does the gentleman from New Mexico seek recognition?

Mr. RICHARDSON. Thank you, Mr. Chairman.

I would like to, like everyone else on the subcommittee, commend the chairman for holding these important hearings, and I think as Mr. Ritter said, the administration has submitted a package which I think we should carefully consider, and as the chairman may know, I am making an attempt to deal with this issue on a broad basis with some legislation. I think product liability has to include all professions, and I am in the process, a very difficult one, of trying to put something together. But nonetheless, I think what the chairman has done in focusing these hearings has been critically important, and I join my colleague in commending him.

Mr. FLORIO. We are now pleased to move to our first panel of witnesses. I would ask Mr. Rocque Dameo of the American Trucking Association, Mr. Jay Deragon, president of National Risk Management, Mr. F. Paul Pizzi, senior vice president of risk management division of Pilko Associates, and Dr. Deborah Phillips, director of the child care information service of the National Association for the Education of Young Children to kindly come forward.

We welcome all in attendance to our hearing. As with all of our witnesses today, their prepared statements will be put into the record in their entirety. The witnesses may feel free to proceed in a summary fashion.

Mr. Dameo, we understand you just got in after some airport problems. We appreciate your coming here and we will be pleased to hear from you.

STATEMENTS OF ROCQUE D. DAMEO, CHAIRMAN, INSURANCE TASK FORCE, AMERICAN TRUCKING ASSOCIATION, INC., ACCOMPANIED BY LANA R. BATTS, VICE PRESIDENT FOR POLICY; JAY DERAGON, PRESIDENT, NATIONAL RISK MANAGEMENT; DEBORAH PHILLIPS, PH.D., DIRECTOR, CHILD CARE INFORMATION SERVICE, NATIONAL ASSOCIATION FOR THE EDUCATION OF YOUNG CHILDREN; AND F. PAUL PIZZI, SENIOR VICE PRESIDENT, RISK MANAGEMENT DIVISION, PILKO & ASSOCIATES

Mr. DAMEO. Thank you, Mr. Chairman.

We ask that our formal statement be accepted as part of the record. In the interest of time, we will present a brief statement.

The American Trucking Association is increasingly concerned about the insurance crisis. Adjectives like "pending" and "upcoming" can no longer be used, for the crisis is here. It is both an availability problem and a price problem. Unfortunately, we see no immediate solution to the availability problem even with the rapidly escalating prices.

Let me begin with one observation. The insurance crisis is not a trucking industry crisis, it is an insurance industry crisis. As such, the solution will be found in the vagaries of the insurance industry itself, not in the trucking industry. The insurance industry created a set of circumstances described in our full statement, not the trucking industry.

My formal testimony outlines some of the specific impacts that are affecting the trucking industry today and how we are attempting to minimize their impact.

I would like to focus on four areas where the Government can help solve our problem. First, there must be some immediate tort

reform on both the State and Federal levels. Areas to be considered include limiting liability, eliminating punitive damages, reviving the concept of contributory negligence, eliminating joint and several liability, limiting contingency fees, and creating a mechanism for mandatory nonbinding arbitration.

Environmental restoration. For the trucking industry, there are several solutions which would help alleviate this problem and must be acted upon. First is to remove the term "environmental restoration" from section 30 of the Motor Carrier Act of 1980. Prior to 1980, spill cleanup was considered by the insurance industry as property damage and was compensated for under the property-damage provisions of the insurance policy.

Section 30 of the Motor Carrier Act changed this by requiring separate coverage for damage to the environment. Unfortunately, the term "environmental restoration," as damages are referred to in section 30, has become an insurance industry nightmare. It has become so for two reasons: one, the court's decision, which holds insurance companies liable for acts and damages beyond which the individual insurance policy was intended to cover; and, two, because DOT's definition of "environmental restoration" requires insurance coverage for potential as well as actual damage incurred.

The court decisions did not involve truck transportation-related activities. With the combination of the court's decision and the DOT definition of environmental restoration, the insurance industry is extremely reluctant, if not all together unwilling, to write and provide coverage for the scope that appears to be boundless.

Therefore, the insurance industry believes that the term "environmental restoration" should be eliminated from section 30 of the act. Such action would allow them to return to the traditional underwriting practices of compensating for spill cleanup under property damage.

Personal injuries resulting from spills would continue to be covered under the bodily injury aspects of the mandated coverage. In other words, the public would retain the protection sought under section 30 but the risk would become an insurable item. The trucking industry also supports this position.

Let me assure this committee that the trucking industry does not intend to abandon or avoid its responsibility for damage resulting from accidental discharge of goods being transported or for the fuel used to move these vehicles.

Another area needing Government attention is self-insurance. In most industries, a company has the option to be self-insured. While section 30 gives the motor carrier this option, under current DOT and ICC regulations, carriers cannot avail themselves of this statute. On the one hand, the ICC allows self-insurance, but its regulations are so unrealistic and stringent that the authorization to self-insure has not been issued in 20 years. On the other hand, the DOT regulations do not permit motor carriers to self-insure under any circumstances. This contrasts with DOT's handling of the railroad industry, where self-insurance is allowed.

ATA believes that if a carrier can meet realistic requirements, it should be allowed to self-insure. And further, if a carrier meets self-insurance requirements of one Federal agency, all other Federal agencies should recognize this certification.

In addition to the various hearings and investigations being conducted on Capitol Hill, we urge Congress to encourage the ICC to hold public hearings on insurance, to complete its investigation of this crisis and to publish its findings.

Mr. Chairman, that concludes my preliminary statement. I do want to reiterate, though, that the trucking industry must have adequate insurance at stable rates. Failure to have both of these will disrupt the free-flowing of commerce upon which this Nation so vitally depends.

Thank you.

[Testimony resumes on p. 758.]

[The prepared statement of Mr. Dameo follows:]

Statement of the
AMERICAN TRUCKING ASSOCIATIONS, INC.

I. INTRODUCTION

My name is Rocque Dameo. I am President of Dameo, Inc., a small family-owned trucking company in New Jersey. I am here today, however, as the Chairman of the Insurance Task Force of the American Trucking Associations, Inc. (ATA). ATA is the national trade association of the trucking industry. Through its 51 affiliated trucking associations located in every state and the District of Columbia, as well as through its over 3,200 individual motor carrier members and 11 affiliated conferences, ATA represents every type and class of motor carrier in the country: for-hire and private; regulated and exempt.

The trucking industry employs 7.4 million people and generates annual revenues in excess of $200 billion. Each year nine million trucks log more than 140 billion miles with an overall safety record that is almost twice as good as that for automobiles. These trucks, operated by more than 260,000 American firms, haul 77 percent of the dollar value of all freight carried in this country.

The American trucking industry provides an essential transportation service to the largest economy in the world. The essentiality of our industry is illustrated by the fact that access to trucking is considered by business to be the second most important factor in deciding where to locate a new plant, ranking behind only cost of property. It is clear that practical business decisions are made in the confidence that truck transportation will be available when needed.

One of our common objectives -- yours as makers of public policy and ours as providers of a publicly available service -- is to ensure that businesses' expectations of an efficient, responsible transportation service are well-founded. These hearings give us both an essential opportunity to evaluate the proper functioning of a vital transportation industry and to address what is perhaps its currently most difficult problem: the availability of adequate insurance at a reasonable and relatively stable price.

Transportation, like so many other industries and endeavors, equires insurance to cover potential liability exposure risk factors to operate effectively. These include public liability and property damage, workmen's compensation, cargo loss and damage, and umbrella or excess coverages above the retention sometimes use by self-insurers.

II. BACKGROUND OF THE PROBLEM

The historical three to eight-year financial cycles of the insurance industry, determined mostly by interest rates and international reinsurance marketplace dynamics, are beyond the control of the trucking industry.

High interest rates and easily obtainable reinsurance fueled the most recent cycle, a "soft market" from the mid-1970's to early last year. In what is termed "cash flow underwriting," premium dollars from the writing of oftentimes indiscriminate policy coverages by primary underwriters yielded returns from 18-20 percent interest-bearing investments for several years sufficient to offset claims and still realize profits. Sound underwriting practices and effective risk management were generally ignored. It was a buyers' market. A trucking company simply called an insurance broker and got the cheapest rate.

Early last year several factors produced a dramatic turnaround: interest rates dropped by almost a half; reinsurance became expensive; "long-tailed" claims for risks that had been indiscriminately written for in the early "soft market" came home to roost, after lengthy adjudication, in the form of large court awards, particularly for pollution damage and asbestos poisoning;

several global catastrophies, such as the Bhopal incident in India and numerous aviation disasters, also had a substantial impact, as did high state insurance commission-imposed reserve requirements. In short, cash flow underwriting no longer worked for the insurance industry.

A capacity crunch resulted, a $60-plus billion shortfall in reserves. All insurance needs could not be met. The insurance companies had to recoup. Higher premium rates to increase capacity appeared to be the quick answer. Sound underwriting practices and effective risk management also became the urgent order of the day.

Limited capacity was focused on the safer, known risks. Those with what were perceived as unquantifiable, unpredictable, and/or unlimited risks were either dropped from coverage or targeted for arbitrary, skyrocketing premium rates. Hardest hit were the specialty lines of commercial insurance. Trucking found itself in the company of taxis and buses; liquor handlers; those dealing with bank surety bonds -ectors and officers of municipalities and other org s; lawyers, doctors, and accountants; and day care cent among others. A company's safety or claims track record had little to do with premium rates and/or accessibility to underwriters.

III. SEVERITY OF THE PROBLEM IN TRUCKING

Because sound underwriting practices and risk management techniques were by and large not utilized during the "soft market," when the market turned last year there were little statistical data from which an analysis of the devastation of the trucking industry could be drawn. Risks were not quantified, or at best only marginally quantified, during the "soft market."

Hence, we are at this hearing stage knowing only, as Will Rogers would have observed, what our friends tell us and what we "see in the papers." That, however, is substantial and more than enough to paint a picture of the monumental nature of the problem.

It should be pointed out that unlike many of the others listed above who are having difficulty finding insurance coverages at reasonable rates, trucking has Federally-imposed minimum levels of coverage. What does a business concern do when it must meet mandated minimum levels of coverage that it cannot purchase? It seems to us that those who impose such minimum levels have a responsibilty to see to it that coverages for them are available -- at reasonable rates. Trucking's problem above others is that operating with no insurance coverage or coverage below the limits violates Federal law.

Following are some of the things we have learned about the severity of our problem:

* Premium rates for primary coverages for public liability and property damage (PL&PD) for general commodity carriers skyrocketed in 1985 on the average from 250 to 500 percent with no apparent connection with the experience of the insureds. In 1986, it appears they will increase another 100 percent for a two-year increase of 500 to 1,000 percent. We have had carrier after carrier tell us of claims-free records which have had no effect on the rates being quoted to them. Some have been unable to get coverage at any rate, especially the tank truck carriers hauling hazardous materials. Those in the latter category who have been lucky enough to get coverage have absorbed increases of 1,000 percent or higher.

* Workmen's compensation primary coverage premium rates have also similarly shot up dramatically. For awhile during the early stages of the "hard market" they were stable because the state insurance commissioners were holding a lid on them. But within the last eight or nine months, these officials have been forced to remove the lid as a result of pressures brought to bear on them by the insurance companies who argued that increased rates are the only means of increasing capacity and meeting reserve requirements.

* Primary coverage premium rates for cargo loss and damage liability have risen on the average 70 to 150 percent. Some trucking companies have been unable to get coverage with street rates and have had to resort to usage of assigned risk pools in their states.

* Those who have turned to the assigned risk pools in their states to obtain coverages not otherwise available have done so despite the stigma associated with such a move that presents a bad connotation to prospective shipper customers. The demand will outstrip pool funds and capacities. Many carriers have called us to tell us that the coverages they were able to obtain do not meet Federally-imposed minimums.

* While we do not know the percentage to which carriers are increasing their deductibles for self-insurance purposes, we do know that most are being doubled or tripled. Premium rates for the excess coverages beyond the primary coverages are also increasing dramatically, with the level of coverage provided substantially decreased. Most of the insurance companies who will write primary coverage will not write excess. So, many trucking companies cannot get the required levels of insurance.

* Some insurance companies are arbitrarily cancelling policy coverages in mid-term, in spite of the fact that over 30 states prohibit such actions. Several trucking companies have been successful in getting court injunctions reinstating coverage for the policy terms, for example, in Arkansas and Iowa. Apparently insurance companies have made the business and economic judgment that it is better to risk the consequences of such lawsuits than it is to forego the opportunity to use limited capacity acquired from such cancellations to write coverages at the greatly increased premium rates.

* ATA has been receiving an average of 1,000 calls per month on the insurance hot line we instituted August 6, 1985, to assist carriers in pursuing shopping leads.

* On August 9, 1985, the Interstate Commerce Commission furnished us with a list of about 700 underwriters which its files indicated are writing truck insurance. Analysis of that list indicates however, that about 95 percent of the companies listed are writing truck coverage only incidental to the other insurance business they have with the manufacturer or shipper who has a private fleet.

In other words, only about five percent, or 35, are in the for-hire trucking market. Unfortunately, more than 50 percent of these underwriters are in dire financial straits or are pulling out of the trucking market altogether. As a result, rather than 700, orly about 18 insurance companies, as far as we can tell, are financially sound and writing for-hire truck insurance. For example, recently Carriers Insurance Company of Des Moines, Iowa, was taken over by the State Insurance Commissioner, and 5,000 trucking companies were forced to seek a new insurance company. Some could not and were forced into state assigned risk pools. One Minnesota carrier went out-of-business rather than take a 700 percent increase in the assigned risk pool.

* We do not know the number of trucking companies that have gone out of business as a result of their inability to pay for insurance. However, the trade press is full of specific instances from which we know there are many, particularly in the smaller size category. For example, the lead story in the January 7, 1985, issue of Transport Topics was about the demise of General Motor Lines of Roanoke, Virginia. The last issue of Transport Topics in 1985 described three carriers who had gone out of business -- two were the result of increased insurance premiums.

* Literally hundreds of trucking companies had filed independent tariffs with the ICC last year seeking approval of surcharges to their existing tariffs that will allow a pass through to the shippers of the increased insurance costs. The ICC is granting them routinely but is so short-staffed that the agency's employees are not even keeping running tabulations of the numbers. Hence, we do not know exactly how many have filed. The percentages sought range from 1.5 to five percent.

* Tank truck operators have been the most severely hit. Their problems are exacerbated by the Federal government debates over environmental restoration, Superfund, and definitions of gradual pollution over sudden and accidental pollution. As this Committee perhaps knows, several courts have interpreted the fine print on insurance policies regarding gradual/sudden and accidental pollution in ways other than what we believe Congress intended. Tank carriers are experiencing rate increases close to 1,000 percent if coverage can be obtained at all.

* Some insurance companies are nonrenewing suddenly and arbitrarily, with inadequate notice to the insureds. Such actions became such a problem in New Jersey, for example, that the Governor has declared an insurance emergency and has prohibited mid-term cancellations and nonrenewals for a six-month period.

* Numerous unusual exclusions are finding their way into the fine print of insurance policies submitted to trucking companies. Targeted, for example, are owner/operator usages, leased equipment, driveaway operations (motorized cargo that rolls on its own wheels under a bill of lading), and hazardous materials, as examples. The problems are particularly acute in the household goods moving industry which employs the services of over 21,000 interstate owner/operators, over 20 percent of the nation's entire owner/operator population. These small, independent owner/operators, attempting to negotiate for adequate, reasonably priced insurance, face a dilemma.

* Insurance companies are switching from occurence-based to claims made coverages for general liability. This means they will pay only if the claim is submitted during the policy period. The effort is to eliminate "long-tailed" claims. While there is no specific date when commercial auto (i.e., truck) insurance will be claims made, it will happen in the near future. In the meantime, there is the possibility that a motor carrier could have its primary coverage under an occurrence-based policy and its umbrella coverage under a claims made policy.

* ATA's own officers and directors' liability insurance premiums have increased 233 percent despite no claims ever in the history of the coverage.

If carriers cannot find insurance, they have two options: cease operations until they can find insurance or operate illegally. Unfortunately, some appear to be utilizing the second option.

ICC Chairman Reese Taylor reported to Congress in September that 3,393 carriers have had their operating authorities revoked in an 11-month period (October 1984 to August 1985) for failure to have insurance or evidence of other financial responsibility. He also reported that 15,000 others were under investigation for "insurance delinquencies" and that 482 consent agreements had been entered into whereby motor carriers agree not to engage in interstate commerce until they have adequate insurance. He said the agency had obtained 28 civil injunctions which prohibit motor carriers from operating in interstate commerce until they have adequate insurance.

The U.S. Department of Transportation reports that 25 percent of all carriers -- regulated and unregulated -- do not have adequate insurance coverage.

Cost increases in insurance and other areas are affecting truckers of all sizes and shapes, making it more expensive to operate, reducing profits, and causing operating ratios to rise. Declining profit margins, or no profits at all, are bound to have substantial negative impact upon fleet maintenance and, therefore, upon the safety of our highways.

IV. POSSIBLE SOLUTIONS

INDUSTRY

ATA has undertaken a number of activities to mitigate the effects of the current crisis and to work toward long-term solutions.

We first warned the industry about the impending crisis in January 1984 several months before the insurance market turn began to impact. Subsequently, ATA formed an Insurance Task Force composed of association staff members and carrier personnel with insurance responsibilities. The Task Force has met on numerous occasions during the past 15 months to develop recommendations for industry action. The ATA Executive Committee has acted upon those recommendations four times. A list of ATA activities is attached.

Since the crisis is an insurance industry problem that is international in scope and trucking is just a small portion of those affected, easy short term solutions are simply not available. Therefore, the Task Force concentrated on (a) short-term efforts to ease the crisis and (b) in-depth study of possible long-term solutions.

Among the short-term efforts were two educational "How to Cope..." seminars for the industry were held in May and October of 1985 utilizing state-of-the-art-versed nationally known and recognized experts. The consistent message from various speakers was that motor carriers must take determined action to avoid, prevent or reduce the risk of losses -- action ranging from safety programs to researcing their records and implementing effective risk management. Five more such seminars with the same message were given in February.

Another short-term effort has been directed toward providing assistance to carriers in obtaining coverage. Many carriers are out of practice in "hard market" shopping. ATA staff members had been reacting to their calls for shopping leads for at least twelve months on an informal basis when in August 1985 we formalized the service with the "Insurance Hot Line" mentioned

above which is averaging 1,000 calls per month. In addition to providing shopping leads, we offer referral to professional outside help where shopping has been attempted and complex and difficult problems remain.

A third area of activity has been directed toward the pass through or surcharge for carriers of dramatically increased insurance costs mentioned above. For example, ATA's then Chairman of the Board, Dale Craig, filed the first insurance surcharge with the ICC on July 15, 1985. Since then many more carriers have filed similar surcharges.

Additionally, the ATA on December 17, 1985 joined American Tort Reform Association. The group is dedicated to seeking state tort law reform. ATA was also a founding member of the Coalition for Insurance Availability, formed December 9, 1985.

Other mitigation efforts, some of which are occurring at the state association level, involve assigned risk pools, class action suits for mid-term cancellations, and challenges to the legality and reasonableness of premium rate increases, among other matters. Many truckers and state associations have made recent contact with state insurance commissioners.

With respect to long-term efforts, the ATA Insurance Task Force has realized that before intelligent decisions can be made and/or recommendations made, in depth hard data are needed. Such data are required before we can pursue the setting up of any endorsed group program and/or a captive insurance company, two options under discussion that would increase capitalization in the insurance industry and, therefore, its capacity. Pitfalls with respect to either, but especially regarding the latter, are abundant. How would they have any more success in attracting reinsurance at reasonable rates in international markets than those companies presently trying to get it? Can premium rates for primary insureds in trucking be made competitive in today's market conditions when the risk is spread only among those in one industry? Even if so, could they continue to be competitive and produce financial solvency for the group plan/captive when the next cyclical "soft market" arrives? We must have hard data to make intelligent decisions about such options and/or pursue other possible solutions via government entities.

GOVERNMENT

Solutions to the overall insurance crisis may lie in reform of our tort system. ATA is on the steering committee of the American Tort Reform Association (ATRA). On February 21, 1986,

James Coyne, Executive Director of ATRA, testified before the House Judiciary Committee and suggested several areas where tort reform was necessary, including:

- Limiting liability;
- Eliminating punitive damages;
- Reviving contributory negligence;
- Limiting contengency fees; and
- Creating a mechanism for mandatory, nonbinding arbitration.

We support these suggestions. A copy of Mr. Coyne's testimony is attached.

For the trucking industry's specific problems, there are several solutions which would help to alleviate the problem and must be acted upon.

Environmental Restoration

While all segments of the trucking industry have been impacted, the hardest hit have been those motor carriers of hazardous materials, whose potential, or at least perceived, liability for environmental cleanup following a spill is the

greatest. Since January 1, 1986, however, very few insurance companies have been offering environmental restoration coverage, even though trucking companies are Federally-required to have this insurance as a precondition of transport.

Prior to 1980, spill cleanup was considered by the insurance industry as property damages and were compensated under the property damage provisions of the policy. Section 30 of the Motor Carrier Act of 1980 changed this by requiring separate coverage for damage to the environment. Unfortunately, the term "environmental restoration", as the damage coverage is referred to in Section 30, has become the insurance industry's nightmare. It has become so for two reasons: (1) because of the court decisions which hold insurance companies liable for acts and damages beyond which the individual policies intended to cover, (2) because DOT's definition of "environmental restoration" requires insurance coverage for potential as well as actual damages incurred. While the court decisions did not involve trucks for transportation related activities, the combination of the courts' decisions and DOT's definition of "environmental restoration", the insurance industry is extremely reluctant, or altogether unwilling, to provide coverage where the scope appears to be boundless.

Another problem facing the trucking industry is a recent development. The ICC and DOT require the insurance company to file a form MCS-90, which indicates that the trucking company has adequate coverage, including environmental restoration. However, we are now seeing cases where the insurance company refuses to file this form because of the open-ended definition of "environmental restoration" printed on the form, even though the carrier has the required limits and coverages.

Therefore, the insurance industry believes that the term "environmental restoration" should be eliminated from Section 30 of the Motor Carrier Act of 1980. Such action would return to the traditional underwriting practice of compensating for spill cleanup under property damage. Personal injuries resulting from a spill would continue to be covered under the "bodily injury" aspects of the mandated coverage. In other words, the public would retain the protection sought under Section 30, but the risks would once again become more insurable.

To these beneficial ends, the trucking industry supports eliminating the term "environmental restoration" from Section 30. Let me assure this Committee that the trucking industry does not intend to abandon or avoid its responsibility for damages resulting from the accidental discharge of goods being transported or the fuel used to move the vehicle.

Self-Insurance

In most industries, a company has the option to be self-insured. While Section 30 gives motor carriers this option, under current DOT and ICC regulations, carriers cannot avail themselves of this statute. On the one hand, the ICC allows self-insurance, but its regulations are so unrealistic and stringent that an authorization to self-insure has not been issued in over 20 years. On the other hand, DOT regulations do not permit motor carriers to be self-insured under any circumstances. This contrasts with DOT's handling of the railroad industry where self-insurance is allowed.

ATA believes that if a carrier can meet realistic requirements, it should be allowed to self-insure. Further, if a carrier meets the self-insurance requirements of one Federal agency, other Federal agencies should recognize this same certification.

Federal Investigations

On August 21, 1985, the ATA petitioned the ICC to institute an investigatory rulemaking into the causes and effects of the current increases in insurance premium rates for motor carriers

leading to the adoption of findings and/or rules which assist motor carriers in acquiring and maintaining the required insurance and in controlling the increased costs. (copy attached)

The investigation was formally opened on October 31, 1985, as Ex Parte MC-178. Since that time, the liability crisis has become increasingly worse. More and more insurance companies are dropping out of the trucking insurance market, thus, decreasing capacity tremendously. A" has recently asked the ICC to hold a conference of interested parties so that carriers, shippers, and the insurance industry, as well as the Federal agencies involved, could come together an openly discuss the problem and, hopefully, find solutions. We urge Congress to encourage the ICC to hold this conference, complete its investigation and publish its findings.

V. CONCLUSION

The current insurance problem is going to get worse before it gets better. No one we talk to thinks otherwise. In fact, insurance experts tell us that reinsurance rates are likely to go up 600 to 1,500 percent after the first of the year. The impact will make today's premium rate increases for primary insureds pale to insignificance. Minnesota Insurance Commissioner Michael Hatch predicts that the current multi-billion dollar shortfall in insurance industry capacity that is leaving "roughly nine percent of the commercial lines marketed this year" without coverage will grow "to approximately 26 percent by 1987."

Apparently the current greatly increased premium rate dollars taken in by the insurance companies have had only minimal effect so far in reducing the shortfall. The risk management expert under contract with ATA reports that only about a $3 billion dollar headway in decreasing the shortfall has been made in the past year. At that pace the crisis will last well beyond 1987, the year some experts are predicting the market will stabilize.

Mr. Chairman, the trucking industry has attempted to deal with the insurance crisis separately and through coalitions. But we cannot do it alone. We need your help. That help could begin with:

- Removing "environmental restoration" from Section 30 of the Motor Carrier Act of 1980;
- Allowing reasonable self-insurance; and
- Investigating the insurance crisis.

The American Trucking Associations appreciates this opportunity to share with members of Congress the distressing developments we are experiencing with insurance. We believe that transportation, trucking, and safety are of sufficient vital concern to the nation's economy and the public that action on your part is warranted. We seek adequate insurance coverages at reasonable and relatively stable rates. Failure to deal effectively with the insurance crisis could lead to serious disruptions in the normal market forces which govern the trucking industry and ultimately interstate commerce.

ATA INSURANCE ACTIVITIES

- February 13, 1985 -- Established an Insurance Task Force, chaired by Rocque Dameo of New Jersey.
- May 20-21, 1985 -- Conducted a two-day seminar on risk management.
- July 17, 1985 -- Established an insurance hot line to match buyers and sellers of insurance.
- August 21, 1985 -- Petitioned Interstate Commerce Commission requesting investigation of insurance crisis.
- September 9, 1985 -- Requested National Association of Insurance Commissioners to investigate insurance crisis on state level.
- October 21, 1985 -- Conducted seminar on risk management.
- October 30, 1985 -- Testified before House Public Works Committee on insurance crisis.
- December 2, 1985 -- Filed comments with the Interstate Commerce Commission on its investigation of the insurance crisis.
- December 9, 1985 -- Helped found the Coalition for Insurance Availability to increase public awareness of crisis.
- December 11, 1985 -- Participated as a Panel member at the Liability Insurance Crisis Conference in Washington, D.C sponsored by The Small Business Legislative Council, The Greater Washington Society of Association Executives and The Coalition of Insurance Availability.
- December 12, 1985 -- Hosted an all-day meeting with 12 top insurance executives.
- December 16, 1985 -- Named to Steering Committee on Liability Crisis of the U.S. Chamber of Commerce to coordinate state and Federal efforts.
- December 17, 1985 -- Named to Steering Committee on the American Tort Reform Association.
- January 1986 -- Conducted a series of five regional seminars on risk management throughout the country.

- January 22, 1986 -- Testified before House Public Works Subcommittee on Investigation and Oversight on insurance crisis.

- February 7, 1986 -- Filed comments with the Interstate Commerce Commission opposing the further elimination or proposed reduction in the motor carrier reporting requirement.

- February 1986 -- Petitioned Interstate Commerce Commission requesting a conference on the insurance crisis conducted by a hearing officer. Such a conference will allow parties to work out solutions without talking through lawyers and legal petitions.

Future Actions

1. Early April 1986 -- publication of insurance risk management manual for trucking.

2. March 1986 -- Testify before 3 Congressional Committees on Liability insurance crisis.

3. Possible ATA endorsed insurance program for qualified members.

TESTIMONY OF JAMES K. COYNE

EXECUTIVE VICE PRESIDENT

AMERICAN CONSULTING ENGINEERS COUNCIL

AND

PRESIDENT

AMERICAN TORT REFORM ASSOCIATION

ON

IMPACT OF LITIGATION AND LIABILITY

ON CONSULTING ENGINEERS

AND

INDEPENDENT BUSINESS

BEFORE THE

COMMITTEE ON THE JUDICIARY

ATRA

AMERICAN TORT REFORM ASSOCIATION

FEBRUARY 21, 1986

65-958 O - 87 - 24

Mr. Chairman, members of the Judiciary Committee, my name is James Coyne. I appear before you today as Executive Vice President of the American Consulting Engineers Council (ACEC) and President of the newly formed American Tort Reform Association.

If justice is blind we must do something to correct her vision. Because the vision of American justice has become so distorted, that the scales have been totally tipped to the plaintiffs, and particularly, plaintiffs that can afford high priced trial lawyers. The American civil justice system, which our Chief of Justice Burger has for many years decried, is in danger of seriously damaging our way of life.

Our system of civil justice is based on a fair hearing of the evidence and redressing of wrongs. Today its become an investigation of who has insurance and inventing a legal theory to show why the insured defendent should pay. We have moved from remedy based on negligence or fault to compensation based on injury, the more unlikely and outrageous the better.

Risk for local governments, independent businesses, professionals providing essential services was something computed far down in the budget and covered by insurance. Now risk is top of the agenda at city council meetings, board rooms, and universities. It no longer is a minor budget item for insurance, but is often not only expensive, but increasingly unavailable.

But more importantly, it has put many people in the "risk" business, people who must make the decision, "Do I dare continue to serve on this board of directors, this school board or town

council, this athletic or recreation league?" For many the answer is no. They have decided the risk isn't worth it. This is particularly true of small businesses, volunteer groups, local governments, and special purpose districts. That decision costs us all; not in dollars, but in the quality of our communities.

For the others who choose to take the risk, however, it changes the way they make the decisions that matter. Rather than innovation, new products, new services, new markets, public and private managers have to worry about, "What's the chance I'll get sued?" In this stifling climate of anxiety over unknown risk, our economic growth, perhaps even our spirit of adventure and pioneering, will be reduced.

How does this directly relate to consulting engineers? Our members have been consistently in the forefront of responding to the major challenges of this century. The great strides in transportation, communications, buildings, energy generation, pollution control and even historic preservation are all dependent on engineering, most of it done by independent professional firms. Yet what do we find today.

Liability insurance is today nowhere available for hazardous waste removal engineering nor for the design of the rehabilitation of federal buildings, when asbestos is present. Firms performing structural engineering necessary for construction of dams, wastewater treatment plants, bridges, as well as public buildings, experienced an average increase in premiums of 54% in 1985.

The pollution exclusion published by the insurance industry in mid 1985 may eliminate coverage for environmental firms designing pollution control systems for water and air.

But the root cause of the crisis we believe is not in the insurance industry, but the American civil justice system. Five years ago a small minority of our firms were sued by their clients to remedy design errors or by personal injury claimants. Today it is not uncommon for engineering firms to have multiple suits at all times pending. Architectural/engineering (A/E) firms in 1985 averaged 109 new claims/100 firms and 210 claims pending/100 firms.

What we have in public, as well as private and commercial projects, is a crisis in tort liability. This crisis extends to every facet of business life.

What is the crisis of our tort system? For that matter, what is tort law? For those of you who are not legal scholars, tort law is the law of civil wrongs other than the breach of contract. It's the framework for most of the lawsuits in America today.

A little historical perspective is needed to understand how we got to where we are.

There are two broad areas of the law: criminal and civil. Tort law falls under the civil category and includes everything from slip and fall cases to automobile accidents to libel suits.

The rules in tort law center on what kinds of injuries can be compensated and what has to be proved to win the lawsuit. We inherited these rules from English common law. In the past,

changes in these rules evolved slowly, largely from court decisions, not from statutes.

In America, we have 50 different state court systems and hundreds of federal courts that must interpret and apply these laws. There is often a difference between the rule in one place and the rule applied in another. Overall, however, most court decisions on tort law have followed the same general trend.

Surprisingly enough, even with all the minor adjustments and additions made through nearly 200 years of American court decisions, the balance struck by English common law remained essentially the same from the early 1800s until the 1960s.

With limited exception, a person suing could recover only if he proved that the defendant was at fault--that the defendant's negligence caused the injury. If the plaintiff--the person bringing the lawsuit--was the primary cause of his own injury through negligence or d[illegible]berate conduct, he could not recover.

Plaintiffs could usually get damages for intangible pain and suffering only if there was an accompanying physical injury. And punitive damages--punishment awards over and above compensation for injury--were available only for truly outrageous conduct. In other words, tort laws were defined in such a manner that one only obtained redress for cases of true negligence, not for the personal risks of everday life.

The tort system we have today--only 25 years later--is vastly different. Our generation has overturned 200 years of legal tradition.

To illustrate recent changes, let's look at just a few of the important decisions of the last 25 years in California. I have chosen California because its lead has often been followed by other states.

In 1961, California rejected the common law doctrine of sovereign immunity, which for centuries had protected cities and states from lawsuits. In fiscal 1984, California cities--that's California taxpayers--paid out more than $19 million in claims, up from $5 million just three years ago.

In 1962, the concept of fault was tossed aside in the area of product liability. Now, an injured person doesn't have to prove any negligence--just that the injury might have been prevented by a different product design. That's how you get lawsuits against telephone booth manufacturers for not making their product crashproof.

In 1968, the California Supreme Court changed the standard of care owed by landowners, extending the duty of "utmost care" to even criminal trespassers. You can now see why a burglar robbing a school can successfully sue for injuries.

In 1975, California replaced the doctrine of "contributory negligence" with "comparative negligence." Comparative negligence allows an injured party to recover if he is partly--or even primarily--at fault for an accident.

Not only has legal doctrine been substantially altered, the dollar value of awards has ballooned. The tort system today has more million dollar winners than a state lottery. You may think that the high awards you read about are aberrations, but in 1984

the average product liability verdict was over a mill' ,n dollars. The average medical malpractice award was $950,000.

Courts today also have become more liberal in awarding punitive damages. Recently, an insurance company disputed the proper settlement amount with a couple whose car was rear-ended. The insurance company offered $4,500; the couple believed they were entitled to $17,000. They sued, claiming the insurance company had failed to settle their claim in good faith, and recovered $7.4 million in punitive damages. Regardless of who was right or wrong, the punitive damages awarded were totally out of proportion to the c'aim at hand.

And courts in many states are handing out extraordinary awards even where there is no physical injury, just the mental trauma caused by watching an injury happen to someone else, or the worry brought on by fear that an injury might occur in the future.

Huge damage awards are a recent phenomenon. The first million-dollar tort verdict was awarded in 1961. In 1983 alone, this country settled 360 cases for $1 million or more. By comparison, in the entire judicial history of Canada, there have been only six $1 million tort cases--and three of those cases, applying Canadian law, were decided by U.S. courts. No other country pays these huge amounts.

The financial cost of our tort reparations system is staggering: In 1984, the tort system was estimated to cost 37 times as much as it did in 1950. Commercial liability insurers alone

spent $2.9 billion defending suits in 1983; and legal defense costs had risen to 25 cents per premium dollar, compared with 5 cents per dollar in the 1950s.

Think of it instead as the dean of Stanford Law School did -- as litigation pollution, or more precisely, as a disease dramatically weakening our nation.

It's a disease with 16.6 million lawsuits in America last year (Japan had less than 1% as many). It is a disease which consumes as much as $60 billion of our GNP, and wastes some of America's finest minds, best products, most successful research and production facilities and saps the creativity and energy of our public and private enterprises. And it's a uniquely American disease. Two thirds of the world's lawyers are in the U.S.

What are the symptoms? Such lawsuits occur everywhere -- sometimes for the most frivolous reasons. They are reported in any newspaper almost any day and liability awards from these suits show no relationship with fact, fault or fairness. The acute symptom of the disease is a plague of insurance policy cancellations and premium increases.

Most of the 1986 policy renewals among our members for liability insurance show increases from 50 to 900%. Furthermore, almost everyone's deductibles are being doubled and limits of liability are being reduced.

The consequences for hazardous waste cleanup engineers, as we described above, as well as nurse-midwives, day care centers, asbestos removal contractors, ski areas, small towns and commu-

nity colleges, LP gas distributors, new drug companies, landfill operators and thousands more, are they have to go bare -- no one will write insurance at any price. They're facing bankruptcy, liquidation or the deadly game of litigation roulette. More than 13% of all ACEC firms went "bare" in 1985, but more sadly 1 in 3 of all of our smallest firms either cannot afford or cannot obtain liability insurance. As a result, the public is unprotected, as well as these independent businesses.

We're here today to introduce ATRA. We want to find a cure to this disease. We feel that basic tort reform is the only answer, together with a fundamental change in public attitude toward tort litigation. ATRA is the first and only national association to join together a broad army of public and private organizations to fight this litigation pollution. As you can see, we include professionals and trade associations, some of the biggest and some of the smallest. Our charter member organizations represent more than 960,000 businesses, professionals, schools, communities, partnerships and public entities. Collectively, they employ more than 19 million tax paying Americans. And we expect more than 200 other associations to join within 30 days. We are all committed to curing this disease, lowering liability premiums, litigation expenses, and reducing the frequency of unjust and irrational lawsuits. We have a two-pronged agenda. First, build a broad-based bipartisan public organization with the resources and capabilities to demonstrate to our nation's policymakers what has to be done. Many lawmakers hear

only the voice of the Association of Trial Lawyers of America (ATLA). In fact, the multi-million dollar war chest they've raised to oppose tort reform demonstrates how their own self-interest is leading them to ignore their duty to the public.

Second, we intend to carry this effort to 50 state capitals this year. Tort reform will not come only by the efforts inside Washington's beltway. It will be the #1 issue in at least 40 state legislatures this year. We stand ready to support these state efforts, especially with the help of the American Legislative Exchange Council, the leading organizations of state legislators concerned about tort reform.

Of course, national leadership is forthcoming. Attorney General Meese has created a special Working Group within the Domestic Council to propose tort reform proposals. Ass't. Attorney General Willard calls tort reform his #1 priority.

The membership of ATRA spent an afternoon at the White House just two days ago to air our concerns and explore ways we can help achieve our goals.

Chief Justice Berger tells the story of a small town with only one lawyer who is about to close up shop for lack of business. But then another lawyer moves in -- now both are thriving. The Chief Justice has called for tort reform and the Judicial Conference, which he chairs, is actively reviewing several proposals.

Of course, Congress, too, will hold hearings. We believe it fitting that the Judiciary Committee, which is responsible for the nations's court system and federal legal structure, is the first

Senate Committee to hear the ATRA message. Tort reform will certainly be an important item on the Congress' agenda this year.

The battle has begun. Much has to be done. The public needs to get a better understanding of how the arcane subject of tort law so severely affects their lives and their livelihoods.

We are confident of the success of our effort because of the broad public and private support and interest we have already received. We are confident that our friends in Congress will be interested and committed to join us in this effort.

What is the solution? We can't look to the lawyers to solve the problem. Abraham Lincoln, a lawyer himself, once said that the highest duty of an attorney was to discourage litigation. While I certainly support his view, it is a tough standard. It's like asking doctors to discourage medicine or ad agencies to discourage advertising. In fact, just the opposite is happening as lawyers increasingly advertise for tort clients.

We can't look to insurance companies to solve the problem. As middlemen, insurers are in the business of spreading risks in a society, not picking up the tab for them. Insurance is unusual in that it must price its product to cover the cost of lawsuits today and many years into the future. As long as the courts define the rules, the policies will be competitively priced to reflect those rules. If the liabilities are undefined, the insurance cannot, or should not, be written.

Finally, we can't look to the courts alone to solve the problem. Courts are focused institutions which decide narrow

cases involving the parties before them. Only occasionally do they see repercussions beyond the immediate case. If they did, they would probably not have set many of these recent precedents.

It took 25 years of case-made changes in doctrine to create our most litigious society in the world; but we do not have 25 years to correct it. The stakes are simply too high. So, if we can't look to the lawyers, and we can't look to the insurance companies, and we can't look to the courts to solve the problem, who can we look to?

The answer lies with us as citizens and with the legislature. But the legislature will not act until the voters make their voices known. Everyone must get involved because everyone is paying the price--municipalities, businesses, citizens and even the trial lawyers, who are themselves having trouble getting liability insurance.

It is time for all of us to step back and readdress some basic questions:

- Is fault still important?
- Where do we draw the line on defining and assigning liability?
- Should there be limits on financial damages?
- When does ease of suit cripple the productive elements of society?

These questions--and others--are big, important and complex. They must be thoroughly analyzed and debated at the local, state and national levels by everybody, not just the experts. We must understand the issues. We must talk to one another. We must involve our legislators. Only then will the system begin to change.

The following are some solutions we might consider:

1. Put limits on liability.

   o Limit pain and suffering awards, particularly when there's no physical injury or when the injury occurred to someone else.

   o Reduce size of awards where the impact of taxes, expenses and collateral sources are significant.

2. Punitive damages. The original justification for punitive damages was to deter outrageous behavior, willful and wanton misconduct. In recent years, this good standard has been diluted to the point of capriciousness.

3. Revive comparative negligence. This doctrine allows plaintiffs to recover large damages even if they are more responsible for the injury than the defendant. That's what allows people who throw themselves in front of subway trains to recover hundreds of thousands of dollars from the taxpayers. It should be possible for judges to dismiss lawsuits at an early stage if the plaintiffs are clearly responsible.

4. Eliminate joint and several liability. The defendant should be financially responsible only for his own fault in the incident, and not for someone else's fault if that person can't pay.

5. Limit the contigency fee system. This encourages frivolous lawsuits and provides an irresistible incentive to extend the line on defining liability.

6. Create a mechanism for mandatory, non-binding arbitration of smaller claims , which make up the bulk of tort cases. If a plaintiff then carries his case on to the courts, he should pay defense costs if he does not prevail.

We think that the Alternative Dispute Resolution Act and the Litigation Abuse Act are two steps in the right direction. We urge the Judiciary Committee to become the Senate leaders for tort reform. Pieces related to specific professions or remedies have been introduced elsewhere but this is the Committee where the leadership focus should be.

Someone once said that people get the kind of government they deserve. In a democracy, it's also true that we get the kind of civil justice system we deserve.

I think we deserve a system that is predictable. A system that provides prompt, just and full compensation to injured victims at a reasonable cost. A system that does not make each of us a potential target for lawsuits arising from someone else's accidents. A system, in other words, that does not outrage our common sense notions of justice.

Thank you for the opportunity to present our views today. I will be happy to answer any questions.

BEFORE THE
INTERSTATE COMMERCE COMMISSION

EX PARTE NO.________

PETITION FOR
INVESTIGATORY RULEMAKING
MOTOR CARRIER INSURANCE RATES

AMERICAN TRUCKING ASSOCIATIONS, INC.

By: WILLIAM S. BUSKER
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Dated: August 21, 1985

BEFORE THE
INTERSTATE COMMERCE COMMISSION

PETITION FOR
INVESTIGATORY RULEMAKING
MOTOR CARRIER INSURANCE RATES

COMES NOW the American Trucki·g Associations, Inc. (ATA), pursuant to 49 U.S.C. §10321 and 11701, and 49 C.F.R. Parts 1110 and 1117, and hereby petitions the Commission to institute an investigatory rulemaking into the cause and effects of the current increases in insurance premium rates for motor carriers leading to the adoption of findings a ./or rules which will assist motor carriers in acquiring and maintaining the required insurance and in controlling the increased costs.

Identification and Interest of
American Trucking Associations, Inc.

The American Trucking Associations, Inc. is a national trade association which represents the interest of the trucking industry throughout the Urited States. It is a federation whose membership is the individual motor carriers and affiliated trucking associations in each of the fifty states and the District of Columbia. The association

participates regularly in proceedings before the Commission, other state and federal agencies, and in state and federal courts representing the interests of the motor carrier industry.

ATA is joined in this petition by the American Movers Conference; Film, Air and Package Carriers Conference, Inc.; Interstate Carriers Conference; Munition Carriers Conference, Inc.; National Automobile Transporters Association; Private Carrier Conference; Regional and Distribution Carriers Conference; Regular Common Carrier Conference; and Specialized Carriers and Rigging Association.

Statement

The Congressional goal of the Motor Carrier Act of 1980 toward maintaining a safe, efficient, economically sound and competitive, privately owned motor carrier transportation system, 49 U.S.C. 10101, is being hampered by the current "hard market" in the insurance industry. Motor carriers are faced with the obstacles of staggering increases in their insurance premium rates, withdrawal of many insurance carriers from the motor carrier insurance market, and severe limitations on the number of policies that insurance companies staying in the market can or will write. Motor carriers are not only finding the Congressionally required

insuranc- more expensive but more difficult, or even impossible, to obtain.

Pursuant to the provisions of section 10927 of Title 49, United States Code, 49 U.S.C. 10927, the Commission cannot issue an operating certificate, permit, or certificate of registration to a motor carrier until that carrier has submitted evidence of a bond, insurance policy, or other type of security, approved by the Commission, in an amount sufficient to cover all environmental, personal liability, or loss or damage of property judgments against the carrier. Further, a carrier's certificate, permit, or registration remains in effect only as long as the carrier maintains the required insurance. 49 U.S.C. §10927.

The current insurance market makes it difficult for new and existing carriers to ob n the insurance necessary to comply with this requirement. Further, those carriers who are able to obtain insurance are often faced with serious delays in acquiring the coverage required, and when insurance is available it is at a highly inflated rate. The amount of a motor carrier's insurance rate increase bears no apparent relationship to the individual carrier's or the motor carrier industry's claims ratio or claims history. A carrier's rate increase appears to be a function of the financial needs of the individual underwriter(s) rather than the claims record

of the carrier. Increases of 300% to 400% are more and more common throughout the motor carrier industry. Increases of 500% or more are not unheard of.

The Commission is well aware of the existence of these problems. The crisis facing the motor carrier industry has been demonstrated by the number of carriers who have sought individual permission to adopt insurance surcharges and the great increase in the number of carriers the Commission's enforcement arm has discovered which have been forced by the current crisis to attempt to operate without insurance. The number of such enforcement actions brought by the agency this year, compared to the number brought in prior years, has increased dramatically.

To offer some help to the industry, ATA has recently instituted an "insurance hot line" intended to answer carriers' insurance-related questions and to guide carriers to sources of available insurance. The "hot line" has been receiving 35-50 calls a day. It is clear that insurance availability and insurance rate increases are one of the major problems facing the motor carrier industry today.

Focus of the Investigatory Rulemaking

For the above stated reasons, ATA requests that the Commission initiate a two-stage investigatory-rulemaking. In the first part of the proceeding, the Commission should seek public comment as to the depth and cause of the insurance crisis in the motor carrier industry; the relationship, if any, between the premium rates charged carriers and the carriers' claims ratios, etc.; the availability of insurance and the prevailing rates for insurance in the industry. The agency should also examine how many carriers have been forced to cease or curtail operations as a result of their inability to obtain insurance coverage or obtain it at a reasonable rate. The Commission should also investigate the effectiveness of insurance surcharges in easing the financial burden on individual companies and determine the feasibility of adopting a general insurance surcharge for the motor carrier industry and determine what other relief is available or required to alleviate the current crisis.

The agency should obtain responses from members of the insurance industry, using its general subpoena powers, 49 U.S.C. §10321, to obtain the information needed to study this problem.

After conducting the first phase of the proceeding, the ICC should release their Finding of Facts and Recommenda-

tions and promptly, in accordance to the findings made, institute the appropriate rulemakings or policy proceedings and submit recommendations to the Congress for legislative action.

WHEREFORE, the American Trucking Associations, Inc. respectfully requests this Commission to initiate an investigatory rulemaking into the causes, effects and possible remedies of the insurance crisis now facing the motor carrier industry.

Respectfully submitted,

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Mr. FLORIO. Thank you very much.
Mr. Deragon.

STATEMENT OF JAY DERAGON

Mr. DERAGON. Thank you, Mr. Chairman and members.

My name is Jay Deragon. I am president of National Risk Management out of West Falmouth, ME. I am an independent risk management adviser to the American Trucking Association, other trade groups and associations, as well as individual motor carriers.

This morning in a brief statement I would like to voice my opinion and views on the current issue as I see it and some probable solutions, both short term and long term. Due to time restraints, I was unable to submit a formal statement; however, I will submit one in the future.

First I would like to address the insurance industry and its practices. Traditionally, we have seen the insurance industry go through cyclical changes in their pricing methods. Factors involve the interest rates, the economic climate, as well as reinsurance marketplace.

These changes affect the American economy in their inability to provide stable pricing. The current crisis, which is a crisis that we are going through, is the worst since 1906 in the San Francisco earthquake. I find it unreasonable to think that the insurance industry in 1983 made a profit and in 1984 are claiming $3.6 billion in losses.

The question I have and many other people have is they are one of the largest financial institutions in this country, and aren't they able to predict trends, changes, and provide a stable environment to adapt to these changes and trends. The current crisis sees swings of 500 to 1,000 percent increases in liability insurance, not only for the trucking industry but for other industries as well. Why, over a period of 1 year, if this current tort system has evolved over the last 5 to 10 years, should the swing affecting the American economy come all of a sudden?

The insurance industry is in the risk financing business. Their ability to finance risk is based on their ability to measure risk. Currently, the motor carrier industry is faced with these huge increases, and yet no answers regarding trucking and its experience as a risk.

Trucking is thrown into the category as commercial auto. Being a large industry, the insurance industry categorizes risk, and again, trucking is labeled as commercial auto, thrown in with buses, taxicabs, every type of commercial auto you can imagine.

My question is what is the experience of the trucking industry compared to these others? Part of risk financing is spreading the risk and the financing of those risks. Should we investigate a probable alternative in determining other methods of risk financing by individual group? Is it fair that the trucking industry pay the high premiums due to the overall experience of what is called commercial auto, or should special segments within that category be treated individually?

A more detailed approach to the problem is to identify the problem areas within that group and address them.

The trucking industry is well aware of the risks that they impose to the public. The American Trucking Association has conducted risk management seminars, they publish a risk management manual, they have an insurance hotline. Not just currently, but in the past they have also publicized many manuals and publications on management and who to deal with their risk. They are well aware, and probably more than the insurance industry, of their risks and how to control them.

Currently the Federal motor carrier safety regulations provide a sound base of practices and standards. The problem as I see it is that the field engineers or representatives of the DOT could not conceivably visit thousands of trucking companies with their current staff to make sure that the trucking industry as a whole is complying with the Federal motor carrier safety standards.

As voiced previously, there should be surprise visits. There should be more stringent compliance. In my experience in what DOT has done, they have gone in and reviewed an average of 10 driver files in the company that has 200. Shouldn't we review all the files to be assured that that motor carrier is complying with Federal motor carrier safety?

Other issues that can be of help to the motor carrier industry in controlling their risk, the Motor Carrier Safety Assistance Program, which really is an adjunct to the DOT Federal Motor Carrier Act, in which more field representatives can be available to be sure that the majority of the trucking companies out there are complying.

Driver disqualification. Should we provide higher standards for a driver to become a professional truckdriver and not a last resort for employment? Certification of safety fitness. Again, the Federal motor carrier safety regulations provide maintenance rules and regulations, driver qualification files. Higher standards of measuring these can help the motor carrier industry better control the risks in field who are not cooperating and complying with Federal motor carrier regulations.

Classified licensing. The problem the motor carrier industry is facing in measuring its risk—which, by the way, the biggest risk is the driver—is checking out his previous employment record and checking out whether or not he has multiple State licenses. There is no uniformity in this issue and should the Federal motor carrier regulations include uniformity on the State levels.

National driver register is another facet of measuring risk for the motor carrier industry.

All State regulations should be uniform so that the motor carrier can have a better method of streamlining his operation and understanding the risk and ways to measure the risks and control them. The insurance industry is in support of this and so is the motor carrier industry.

Again, I cannot emphasize enough the importance of field inspections by the Department of Transportation. The motor carrier industry, like all industries, realizes that not all members of that industry will cooperate and comply and provide professional service to the public at safe standards. Increase in inspections would help eliminate those individual motor carriers who are noncomplying and providing a risk to the public.

The current legislation on the Risk Retention Act is a short-term opportunity for solution; however, we must realizes that no matter what we propose in enacting the Risk Retention Act, we are going to be involved with the insurance industry, at the whims of the reinsurance rates.

It may be a short-term solution, but long term it could cause the same problems we are facing, and that is higher cost to the business industry due to cyclical changes.

To end my testimony, the great historian in America, George Santana, once said that those who forget the past are condemned to repeat it. The insurance industry is repeating what they have been through historically since the beginning of their industry. The future will be more stable if we can educate one another, eliminate the poor risk, and transfer the responsibility to the people who are responsible on the primary level.

Thank you.

Mr. FLORIO. Thank you very much.

Mr. Pizzi, we have a vote. What I think we will do is take a 10-minute recess, and when we reconvene, we will be pleased to hear from you.

The committee stands in recess for approximately 10 minutes.

[Brief recess.]

Mr. FLORIO. The subcommittee will kindly reconvene.

Dr. Phillips, I understand you have the problem that most of us in Congress have, being required to be in two places at one time. I am sure there will be no difficulty in allowing you to go next.

STATEMENT OF DEBORAH PHILLIPS, PH.D.

Ms. PHILLIPS. Thank you very much. Mr. Chairman and members of the committee, my name is Deborah Phillips. I want to thank you very much for inviting me to testify on behalf of the National Association for the Education of Young Children.

I will submit my full testimony for the record. This morning I will summarize the statement.

The National Association for the Education of Young Children or NAEYC, is a nonprofit membership association comprised of 50,000 individuals who work in all facets of early education. For the last 10 months we have been receiving between 150 and 200 calls each week from providers who cannot find affordable liability insurance, if they can find insurance at all. We have never received this magnitude of calls on any single issue in the 60-year history of the association.

It is particularly rewarding to see this subcommittee emphasize issues of prevention. While the immediate problems associated with the shortage and cost of insurance are immense, it is critical to look ahead to ways of preventing a reoccurrence of what has now been determined to be a cyclic problem.

Last November, NAEYC conducted a random national survey of the child care field to assess the magnitude of the insurance crisis. Almost 300 surveys were returned from child care providers in 43 States, thus giving the results national scope. Our results have been corroborated many times over by State and local surveys that are summarized in the full text of my testimony.

Today I would like to give you a few of the themes that have emerged from the survey results. First, they document that the insurance problems experienced by child care providers appear to be worsening. Whereas only 20 percent of the programs surveyed last summer had experienced cancellations and nonrenewals, the current results show that 60 percent of family day care homes and 34 percent of centers are reporting these problems.

Second, the data make it clear that the negative characterizations of child care as a risky or unprofitable business are completely unfounded. Nine out of t-n programs responding had never had a claim on their liability insurance policies. Of those with claims, 80 percent had claims that were less than $500 total. The largest single claim was for only $15,000.

Child care is a sound insurance risk. There is no actuarial basis for the cancellations and exorbitant rate increases that are jeopardizing the availability of essential quality child care in this country. There is no evidence that large numbers of huge claims are surfacing from the child care field. We have asked for this evidence from the insurance industry and they haven't produced it. Prior congressional hearings have requested this information and it was not forthcoming.

This week I spoke to staff of the General Accounting Office who looked at the Insurance Services Office data and they threw their hands up. They can't interpret the data. They don't believe the evidence is there.

Third and perhaps most troubling, the quality of our Nation's child care programs is being jeopardized as a direct result of the insurance crisis. We inquired about how programs plan to respond to their insurance problems. Most responded that they would raise parent fees where possible and they would cut into their operating budget in addition. But increased parent fees will not go to staff salaries or to new books or improved meals. They will go to the insurance industry.

There is no maneuvering room in a child care budget. The child care directors I have spoken to are planning to hire staff with less training, to have fewer staff for supervising children and to cut back on their educational resources. These are precisely the elements of an early childhood program that guarantee the safe and healthy development of children. The price of the insurance crisis in child care will be paid by the children who will receive lower quality are.

For programs that can increase parent fees, the dollar amounts are not trivial. Annual increases of $100 to $350 per family per year were quoted to me by programs that serve predominately low-income families. Head Start programs and programs that serve title XX children are unable to pass increased costs on to parents. They receive a set reimbursement fee per child. There are no parent fees to raise. Not surprisingly, in our survey, 11 percent of the Head Start programs that responded indicated they plan to close and 61 percent reported they would need to reduce services.

Among family day care programs, it is not just quality that will be sacrificed. These programs are, in fact, closing. A survey by the Children's Foundation, an advocacy association for family day care

providers, revealed that 30 percent of the programs responding to their survey reported plans to terminate.

How effective have State and national responses been so far? The responses from the States to the insurance problems of child care providers have been very uneven and generally unsuccessful. They are not addressing the affordability issue at all. There are no assurances that once the insurance industry bounces back from this financial cycle, it won't all happen over again a few years from now.

Several States like Maryland, California, and Pennsylvania have established marketing assistance plans. In Maryland, when I asked whether the MAP had helped child care providers, I was told "it is a disaster." In Pennsylvania, family day care homes were not included in the MAP and there is an application fee of $150. In California, I was told by the representative from the American Insurance Association, who administers the MAP in California, that "they have not written the number of applications anticipated." The staff of State Senator John Seymour who authored the MAP legislation recited a litany of concerns. They include poor publicity and a laborious application process. They also noted that the premiums for programs insured through the MAP are slightly higher than those insured independently, even though the MAP was not constructed as a high risk pool.

In New Jersey, despite Commissioner Gluck's commendable efforts to prevent the insurance problems from snowballing, child care representatives and State officials told me the rates are still skyrocketing and family day care providers are still completely without coverage.

At the national level, two policies have been established to serve child care providers. One policy only covers high quality programs using NAEYC's criteria for high quality child care. These criteria exceed most State's licensing standards. This policy will not cover programs that receive a substantial share of their support from Government funds, like Head Start programs. It is restricted to center based programs. It is not helping family day care at all.

The second policy is undergoing the approval process in each State's office of insurance. To date, it has been approved only in 15 States; 20 States have disapproved the policy. It is pending in the remaining States. This is a far cry from national coverage. Moreover, the rates of this policy vary tremendously by State, from a high of $204 per child in New York, the rate in New Jersey was set at $136 per child, to a low of $10 per child in South Carolina. There is no rhyme or reason to these rates. They do not correspond to the caliber of the licensing laws in the States. There is a minimum premium of $500 per policy. To put this in perspective, family day care providers were paying between $100 and $150 per year for their entire coverage just a year ago.

In sum, we are left with a patchwork of insurance that leaves the majority of programs without coverage. All programs are experiencing rate increases. Sometimes they are small but more typically they are exorbitant, extracting two to three times the premiums paid just a year ago. Many family day care homes are simply being priced out of the market or left without any coverage.

There are three enduring issues for child care with respect to the insurance crisis. The first is predictability. Our field has been se-

verely hurt by the actions of a desperate insurance industry whose unwise boom-bust investment policies have caught up with them. The child care field simply cannot absorb sudden increases in operating costs. If the changes had come more gradually, programs would have been much better equipped to respond.

For this reason, NAEYC is very supportive of any effort to lend greater oversight and predictability to the insurance market. No existing regulatory mechanism has effectively addressed this issue.

The second is improved information. The lack of any sound actuarial data on child care has appalled us, particularly in light of the major decisions that are being made by the insurance industry. Insurance representatives have acknowledged to us that their rate setting is guided by speculation and fears about the future rather than facts about the present, in the case of our own programs. From what we can tell, the state insurance offices have insufficient control, if any, over the rate setting of the insurance industry. This is intolerable in light of the social and economic ramifications of their decisions.

The third issue is prevention. Insurance companies are using the lack of stringent uniform child care licensing to justify their exorbitant rate hikes, cancellations, and nonrenewals. They tell us there is no loss control or risk management in the child care field. Child care quality, and specifically standards that assure quality, lie at the center of the insurance industry's concerns about child care.

The sad irony in this situation is that child care providers for 15 years have fought for minimum Federal child care standards. Now these same individuals are paying the price for the Federal inattention to child care quality. The cost of this implicit policy of neglect is getting higher all of the time. We in the early childhood profession are making large strides in promoting improved practices, but a national statement of commitment to quality is essential.

This commitment means much more than just Federal child care standards. It means dependable financial support that will make child care quality a reality, not just a goal or a paper document.

The recent decisions of the insurance industry are not just business decisions. They are decisions that can jeopardize the basic social needs of American families and of American businesses. The impact of the insurance crisis has spanned every State and has affected a very broad spectrum of businesses. It is sapping essential resources from child care programs and other core services at a time when they are already making sacrifices due to Federal budget cuts.

We have been patient, Mr. Chairman. We have looked to the States for a reasonable solution to this growing problem. We have waited for an adequate voluntary response from the insurance industry. There have been a few noteworthy attempts to make liability insurance available.

When it comes to affordability. we have been told to wait and see. There are no guarantees or controls to assure that this does not happen all over again. An issue of this magnitude of national and social impact deserves your most careful attention.

We commend this committee ' providing this attention and look forward to working closely with you in the months ahead.

[Testimony resumes on p. 783.]

[The prepared statement of Ms. Phillips follows:]

Deborah Phillips, Ph.D.

Director
Child Care Information Service

National Association for the Education of Young Children

Mr Chairman and Members of the Committee, I want to thank you for inviting the National Association for the Education of Young Children to participate in this extremely important hearing on competition in the insurance industry.

My name is Deborah Phillips. I am speaking on behalf of the National Association for the Education of Young Children (NAEYC) as Director of their Child Care Information Service. NAEYC is a nonprofit, membership association comprised of 50,000 individuals who work in all facets of early education. The vast majority of our members work directly with children in child care programs, nursery schools, and elementary schools. Our principal goal is to promote and support the development of high quality care and education for our nation's young children.

For the last 10 months, NAEYC has been receiving between 150 and 200 calls per week from child care providers who cannot find affordable insurance, if they can find insurance at all. We have never received this magnitude of calls on any issue in the 60 year history of the Association. We been extensively involved in negotiations with the insurance industry, conducted a

national survey, participated in several coalitions of affected industries, and provided technical support to thousands of child care professionals, organizations, and state officials.

This places us in an excellent position to give you a snapshot of how the insurance crisis is affecting the child care field, how effective the resonses of the insurance industry and of the States have been, and where you might be able to make an appreciable difference in the resolution of this problem.

It is particularly rewarding to see this Subcommittee emphasize issues of prevention. While the immediate problems associated with the shortage and costs of insurance are immense, it is critical to look ahead to ways of preventing a reoccurrence of what has now been documented as a cyclic problem.

The insurance crisis has devastated the child care field. Efforts at the state level to rectify the problems have generally failed, particularly with respect to affordability. And, our efforts to establish national child care liability policies have been successful for only select portions of the child care market.

The availability, stability, and quality of child care in this country are being jeopardized at a time when the number of families who rely on child care is increasing exponentially. Child care is essential to the self-sufficiency of millions of today's families. Under these circumstances, the sweeping and unjustfiable classification of child care as of "high risk" by the insurance industry is intolerable.

Magnitude of the Problem

Last November, NAEYC conducted a random, national survey of the child care field to assess the magnitude of the insurance crisis. We asked about recent changes in the availability, costs, and coverage that child care providers had experienced with their liability insurance. Respondents also reported their entire history of insurance claims, and their plans for coping with their insurance problems.

Almost three hundred surveys were returned from child care providers in 43 states, thus giving the results national scope. The bulk of the respondents were directors of child care centers. I would like to submit the full report of the survey findings to the Committee.

These findings document the charade carried on by the insurance industry in their characterizations and treatment of the child care field.

Highlights from the NAEYC survey results:

(1) Two-thirds of family day care homes and one-third of child care centers have experienced insurance cancellations and nonrenewals. This is up to three times the rates reported in a similar survey conducted last summer.

(2) Among programs still able to find liability insurance, 60 percent experienced rate increases during the last year. Over 50 percent are now paying a least twice their rate a year ago. Rate hikes of over 300 percent were not uncommon.

(3) One-quarter of the programs reported that their insurance coverage was narrower than it had been last year.

(4) With respect to claims, 9 out of 10 child care programs surveyed had never had a claim on their liability policy. Of those with claims, 80 percent reported total

claims under $500. The highest single claim was for $15,000. The vast majority of claims were for minor injuries. No claims resulted from child abuse allegations.

(5) Payment on all claims reported by child care programs accounted for a mere 3 percent of premiums they paid during the last year. This does not take the investment income of the insurance industry into account.

(6) Most of the programs reported plans to resond to the insurance crisis either by raising fees to parents or by cutting into their operating budget. Five percent of the programs were considering closing, and only 6 percent indicated that they would operate without insurance. This latter finding is not surprising given that half of the states require that licensed child care centers have liability insurance coverage.

What do these findings tell us?

First, they document that the insurance problems experienced by child care providers appear to be worsening. Whereas only 20 percent of programs surveyed last summer reported cancellations and nonrenewals, the current results show 60 percent of family day care homes and 34 percent of centers reporting these problems.

Moreover, the summer data showed that 30 percent of programs had had their rates increased over 100 percent. Today this figure is 50 percent.

Second, these data make it clear that the negative characterizations of child care as a risky or unprofitable business are completely unfounded. To the contrary, child care is a safe business and a sound insurance risk. There is no actuarial basis for the cancellations and exhorbitant rate increases that are jeopardizing the availability of essential quality child care in this country. There is no evidence that large numbers of huge claims are surfacing from the child care field. We've even asked for this evidence from the insurance industry and they haven't produced it. Prior Congressional hearings requested this information and it was not forthcoming.

For the child care field, this is not a problem that requires tort reform. It is a problem that requires insurance reform.

Third, and perhaps most troubling, the quality of our nation's child care programs is being jeopardized as a direct result of the insurance crisis. Increased parent fees will not go to staff salaries, or new books, or improved meals, but to the insurance industry. Money saved for program improvements will now go toward insurance premiums.

I want to take just a moment to put the economics of the insurance crisis in context. There is no maneuvering room in a child care budget -- the majority of programs are nonprofit and they operate on a shoestring. The portions of their budgets -- staff costs, materials, and services -- that are able to be cut, are precisely the elements of early childhood programs that directly affect the safe and healthy development of young children. The child care directors I have spoken to are planning to hire staff with less training, to have fewer staff for supervising children, and to cutback on their educational resources. The price will be paid by the children who will receive lower quality care.

For programs that can increase parent fees, the dollar amounts are not trivial. A family day care home in California that has operated for five years without any

insurance claims had its rates increased from $100 a year to $800. The caregiver provides child care to 3 children from two families. If she passed the costs on to her parents, they would be charged an additional $350 per year. A child care center in Indiana, directed by a registered nurse would need to charge its families an additional $144 per year to cover her $6,000 increase in rates. A center in California that serves predominantly low-income families would need to charge an additional $100 to cover its jump from an annual premium of $8,000 to $25,000.

Head Start Programs and programs that serve Title XX children are unable to pass increased costs onto parents. They recieve a set reimbursement rate per child, so there are no parent fees to raise. Not surprisingly, 11% of Head Start programs in our survey indicated they planned to close and 61 percent reported that they would need to reduce services.

What is particularly ironic here is that concerns about the quality and safety of child care prompted the insurance industry to stop writing policies for child care. Yet, the few resources that could have been devoted to improving quality will now be drained by the insurance companies.

Fourth, among family day care programs, it is not just quality that will be sacrified. These programs are, in fact, closing. A survey by the Children's Foundation, a national association of family day care providers, revealed that 30 percent of the programs responding reported plans to terminate services. In Fairfax County, six family day care homes have already closed and a county official told me, "I expect to lose a good number at the end of the program year."

Findings from Other Surveys

These conclusions have been confirmed again and again by other smaller scale surveys. For example, in Kentucky, a statewide insurance survey was conducted at the request of a state legislative committee. Nearly half of all the licensed child care facilities in Kentucky responded. More than half of the respondents cited significantly increased premiums ranging from 53% to 900%. Twenty-two facilities are operating without insurance because they cannot afford the premiums. Neverthless, only 27 percent of the respondents reported any claims at all in the past five years and of all of the claims reported, 86% were for under $300. None were for child abuse allegations.

In Alabama, a three-county survey revealed that over 20 percent of the child care programs had experienced cancellations (only one of these programs had ever filed a claim), almost 40 percent had had their rates increased anywhere from 10% to 288%, and only 4% of the programs had ever had a liability claim.

A survey of Region III Head Start programs (Philadelphia area) showed that 42% had experienced rate increases and 2% had had their policies cancelled.

In Fairfax County, a survey of all child care centers found that half of the programs had been notified of cancellations, nonrenewals, or increased rates. None of these centers had ever filed a claim against their center liability policy.

In New Jersey, a survey of 200 child care centers revealed that rates had increased from an annual average of $2,388 last year to $4,135 this year. 17% of the programs voluntarily cancelled their policies, because they could not afford the higher rates. 97% of the programs had never filed a claim, and of the 3% with claims, the highest was $310.

In Colorado, a comprehensive survey of all licensed child care centers and family day care providers revealed that 40% of the child care centers and 20% of the family day care homes had had their liability policies cancelled or not renewed. 44% of the providers reported an increase in their premiums with the increases as high as 700%. Only 7% percent of the providers reported any claims throughout the history of their child care programs. The highest claim was for $200,000 -- all others were below $5,000.

In Michigan, a survey conducted by the State Department of Social Services revealed that 50% of the child care centers had had their liability policies cancelled or not renewed.

The Effectiveness of State and National Responses

The responses from the states to the insurance problems of child care providers have been very uneven and generally unsuccessful. They are not addressing the affordability issue at all. And there are no assurances that once the insurance industry bounces back from this financial cycle, it won't happen all over again a few years from now.

At a very basic level, we have referred child care providers who are looking for insurance to state offices of insurance to obtain a list of companies that are writing child care policies. These people routinely call us back to inform us that their state insurance commissioners are not able to help them identify companies.

Several states like Maryland, California, and Pennsylvania have established Marketing Assistance Plans, sometimes just for child care and in other instances for all affected lines of business. In Maryland, when I asked whether the MAP had helped child care providers, I was told, "It's a disaster." In Pennsylvania, family day care homes were not included in the MAP, and there is an application fee of $150.

In California, there have been very few applications from child care providers. I was told by the representative from the American Insurance Association who is administering the California MAP that they have not written the number of applications anticipated. And, the staff of State Senator John Seymour who authored the MAP legislation, recited a litany of concerns, including poor publicity and a laborious application process. They also noted that the premiums for programs insured through the MAP are slightly higher than those insured independently.

In New Jersey, despite Commissioner Gluck's commendable efforts to prevent the insurance problems from snowballing, by child care representatives and state officials report that rates are skyrocketing and that family day care providers are still without coverage. I was also told that some of the insurance companies responded to the restrictions she placed on cancellations by writing fewer new policies in New Jersey; in other words, they retreated.

At the national level two policies have been established to serve child care providers. The first is offered to NAEYC members who work in child care programs by a division of the CIGNA corporation. This policy is available in 48 of the 50 states. Its rates appear to be quite reasonable, running about $2,500 for a program with 50 children. However, the policy only covers high quality programs using NAEYC's guidelines that exceed most states' licensing standards. It will not cover programs that receive a substantial share of their support from government funds like Head Start Programs, which provide essential child care for low-income families. And, it is restricted to center-based programs, thereby leaving family day care homes without coverage.

The second policy that has just become available is offered by Continental Insurance Company. This policy is available to all licensed or registered child care programs, either center-based or in family day care homes. The policy was submitted to each state's Office of Insurance in January. As of last week, only 15 states had approved the policy, 20 states had disapproved the policy, it is pending in the remaining states. This is a far cry from national coverage.

Moreover, the rates vary tremendously by state from a high of $204 per child in New York (the rate in New Jersey was set at $136 per child) to a low of $10 per child in South Carolina. There is no rhyme or reason to these rates. For example, Idaho which has no mandatory child care licensing has rates of $33 per child, whereas California, with some of the strictest regulations in the country, was set at $141 per child. There is also a minimum premium of $500 per policy. To put this in perspective, family day care providers were paying between $100 and $150 per year for their entire coverage a year ago.

In sum, we are left with a patchwork of insurance that leaves the majority of programs without coverage. All programs are experiencing rate increases. Sometimes they are small, but more typically they are exhorbitant, extracting two to three times the premiums paid just a year ago. Many family day care homes are simply being priced out of the market, or left without any coverage.

Issues for the Future

There are three enduring issues for the child care field with respect to the insurance crisis.

The first is predictability. Our field has been severely hurt by the actions of a deparate insurance industry whose unwise boom-bust investment policies have run amok. The child care field simply cannot absorb sudden increases in operating costs. If the changes had come more gradually, programs would have been much better equipped to respond. For this reason, NAEYC is very supportive of any effort to lend greater predictability to the insurance market. No existing regulatory mechanism has effectively addressed this issue.

The second is improved information. The lack of any sound actuarial data on child care has appalled us, particularly in light of the major decisions that are being made by the insurance industry. Insurance representatives have acknowledged to us that their rate setting is guided by speculation. With respect to child care, it is fears, not facts about child abuse that have contributed to the insurance crisis. And from what we can tell, the state insurance offices have insufficient control, if any, over the rate-setting of the insurance industry. This is intolerable in light of the social and economic ramifications of the decisions of the companies.

The third is prevention. A quick examination of why the child care field was encompassed among the businesses deemed "risky" by the insurance industry illustrates the lack of consistent quality control in the child care field.

Specifically, insurance companies are using the lack of stringent, uniform child care licensing to justify their exhorbitant rate hikes, cancellations and nonrenewals. They tell us there is no loss control or risk management in the child care field. We heard from CIGNA that they would have a much easier time convincing

their agents to market NAEYC's liability policy in states with more stringent child care standards. Representatives from Continental were "on the fence" until they saw the stringent guidelines that accompany NAEYC's new project to accredit high quality child care centers. They were also encouraged when they learned about the Performance Standards that guide the Head Start Program.

Clearly, child care quality and, specifically, standards that assure quality lie at the center of the insurance industry's concerns about child care.

The sad irony in this situation is that child care providers for 15 years have sought federal minimum child care standards. Now, these same individuals are paying the price for the federal inattention to child care quality.

The costs of this implicit policy of neglect are getting higher all of the time. While we in the early childhood profession are making large strides in encouraging improved practices, a national statement of commitment to quality is essential.

Conclusion

The recent decisions of the insurance industry are not just business decisions. They are decisions that can jeopardize the basic social needs of American families and of American businesses. The impact of the insurance crisis has spanned every state and has affected a very broad spectrum of businesses. It is sapping essential resources from child care programs and other core services at a time when they are already making sacrifices due to federal budget cuts. And it is jeopardizing our nation's ability to follow-through with its commitments to clean up toxic waste dumps, to provide reliable medical care, and to assure the safety of our nation's children.

While tort reform has been proposed as a solution to the insurance crisis, we have been concerned that equally important insurance reforms have not received adequate attention. In the child care field, where there is no history of major court claims, we feel the solutions must focus on the decision-making processes of the insurance industry. Moreover, we cannot wait for tort reform, because in the meantime we are losing programs and subjecting children to lower quality care.

We have been patient, Mr. Chairman. We have looked to the states for a responsible solution to this growing problem. We have waited for a voluntary response from the insurance industry. There have been a few noteworthy attempts to make liability insurance more available. But when it comes to affordability, we've been told to wait and see. And, there are no quarantees or controls to assure that this does not happen again. Time is running out.

An issue with this magnitude of national, social impact deserves your most careful attention. We commend this Committee for providing this attention and look forward to working closely with you in the months ahead.

Mr. FLORIO. Thank you very much. Dr. Phillips, since I understand you have to be at another committee, let me just ask you a question or two before we excuse you.

Your industry, if we can refer to it in that way, is really a classic example of where there is no evidence whatsoever of the insurance unavailability or unaffordability being in any way related to loss payout. There is absolutely nothing that has been presented to us at all. There are other examples; nurse midwifery is another area where the evidence is there that there is no relationship between payouts and increases.

The argument that has been posed, and you have stated it as well, is there is no uniformity in standards and therefore there is the potential for speculative losses at some point. As you point out, many of us in Washington for the last number of years have tried to get national standards. The current climate being what it is here in Washington, I don't see a whole lot of hope for that occurring. We can continue to try but I am not overly optimistic.

It has been represented to me that since we last heard from spokesmen from child care and day care centers in September, the market has somehow loosened up. Can you tell us first of all if that is the case, and if it is the case, if anyone has offered you an explanation as to why there has been more availability made for insurance coverage?

Ms. PHILLIPS. The only major development in the field that I am aware of is the Continental Insurance Co.'s plan. That is the plan that has been submitted to every State insurance office. There are apparently problems with the policy. It has only been approved in 15 States. I have spoken to staff in the insurance offices of States that have given me a rundown of some of the problems. If we are left with a policy that is available in only 15 States, the needs of many providers will not be addressed.

Mr. FLORIO. Is this the high quality program you talked about?

Ms. PHILLIPS. No. The high quality program is offered to NAEYC members who direct child care centers. That is a relatively good policy. It is approved in all States except two. The problem here is that it covers only a very tiny slice of the child care field. It doesn't cover family day care. It doesn't cover Government funded programs. It doesn't cover part-day programs.

Mr. FLORIO. It doesn't cover Government funded programs because they are Government funded programs or because the programs are not sufficiently——

Ms. PHILLIPS. Because they are Government funded. We have been told that in other lines of business, and this is through the CIGNA Insurance Co., that Government programs are of lower quality than non-Government programs. In fact, in child care, just the opposite is true. We have presented them with a tremendous amount of documentation of this fact. To date, the evidence has been ignored.

Mr. FLORIO. Thank you very much. Mr. Pizzi.

STATEMENT OF F. PAUL PIZZI

Mr. PIZZI. Good morning, Mr. Chairman and members of the subcommittee. My name is Paul Pizzi, senior vice president, Risk Management Division of Pilko & Associates.

During the past 3 years, Pilko & Associates has been one of the only risk assessment firms universally accepted by the domestic insurance companies offering environmental liability insurance coverage.

I will summarize my written testimony in a brief oral statement and I will be available to answer questions.

First, I am not an insurance expert. I offer this testimony as an environmental risk assessment professional who has been directly and indirectly involved with the insurance industry, regulatory agencies, and various manufacturing and service industries for a number of years.

My testimony is presented to clarify to what degree risk management can be used to improve the insurance crisis as it exists today, specifically in the environmental impairment liability area.

The liability insurance crisis is a multifaceted problem which has its roots in a number of factors. I will quickly touch on the most significant factors here. First, our present judicial system routinely hands down large damage and punitive damage awards in cases brought before the court. The insurance industry is understandably reluctant to offer coverage in this climate, while consumer groups and public advocates insist on continued protection.

The need for tort reform is clear.

Second, media coverage of events involving hazardous and toxic chemicals and waste is often sensationalized and focuses on what went wrong. The constant, negative reinforcement presented by the media ultimately affects the thinking and actions of the public, jurors, judges, insurance underwriters, and reinsurers, cumulatively affecting environmental liability insurance.

Third, during the soft market experienced in the early 1980's, many insurance companies, competing for investment dollars, wrote liability coverage based on unwise underwriting practices, which some call cash flow underwriting. When claims predictably resulted and coincidentally, high interest rates declined, the premium dollars generated were not adequate to cover claims. Only one major insurance company has survived the tightening environmental liability market.

In a soft market, an insurance company insisting on more rigorous environmental risk assessment, prior to binding coverage, would be at a significant competitive disadvantage compared to other insurance companies requiring less indepth or no risk assessment.

A fourth factor is that environmental legislation, regulation, and enforcement has been inconsistent and sporadic at both the State and Federal level. Industry has been given confusing signals about what it needs to do to comply with regulations.

Mr. Chairman, several weeks ago, you addressed the Texas Water Pollution Control Association and made the point that industry needs (and wants) clear guidelines and objective, verifiable

standards upon which it can act with confidence. I echo your point emphatically.

Last, the regulated community has designed environmental programs which focus primarily on technical compliance. In general, an aggressive, proactive approach toward overall risk management and reduction has not been widely pursued. Jolted by the disaster at Bhopal, many companies have recently implemented major risk identification and reduction programs.

Effective solutions to the insurance liability crisis will not be easy. A short term solution, which is receiving much favorable support lately, is the Kasten-Danforth proposed amendments to the Risk Retention Act. Such legislation may offer some relief by providing businesses the option to cover their own exposures in the absence of commercially available liability insurance.

However, sound risk management techniques will be even more critical in this situation, since reserves to cover losses will likely be limited.

Longer term solutions to the liability insurance crisis are certainly needed, such as more consistent enforcement by the regulatory agencies, adherence to sound underwriting practices by insurance companies, reform of the present tort system, and development of strong internal risk management programs within the regulated community.

Risk management can play a key role in relieving today's crisis. By requiring indepth risk assessments, underwriters and reinsurers will have more confidence in decisions to provide or withhold coverage.

One evolving area where the scope of an adequate risk assessment has not been defined is in assessing the risk from sudden and accidental exposures, such as the release of a toxic material from a pipeline rupture. Risk management techniques must be developed which will provide reasonable assurance that major sudden and accidental risks and liabilities are identified and controlled.

Within the manufacturing and service industries, strong environmental risk management programs must be developed and expanded to include some form of risk analysis. Risk analysis is a technical tool that is particularly useful in predicting the probability of successive unlikely events occurring which might result in an environmental incident, such as the deadly gas leak at the Bhopal, India, plant.

Finally the focus of environmental audit programs in industry must be expanded from the traditional technical compliance scope to include environmental affairs management assessments and indepth risk assessment. This expanded focus will assure that environmental policies, procedures, and programs are in place and are effective and that the operations of individual plant facilities—while they may be in technical compliance with the law—do not pose unacceptable environmental risks or long-term liabilities for the company.

I would like to finalize my remarks by asserting that sound risk management practices can and will play a key role in resolving the liability insurance crisis.

[The prepared statement of Mr. Pizzi follows:]

Testimony of

F. Paul Pizzi
Senior Vice President
Risk Management Division

PILKO & ASSOCIATES, INC.

My name is F. Paul Pizzi, Senior Vice President of the Risk Management Division of Pilko & Associates, Inc , a Houston-based consulting firm. Since 1978, I have been directly involved in environmental auditing and environmental risk assessment. During the past three years, Pilko & Associates has been one of the only firms universally accepted by the major domestic insurance companies offering pollution liability coverage. The Company's staff has conducted environmental risk assessments and audits for many types of facilities in numerous industries throughout the United States and in Canada, for clients including manufacturing and service industry companies, insurance companies, investment groups, bankers and attorneys. I will summarize my written testimony in a brief oral statement and I will be available to answer questions, if asked.

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I must first declare that I am not an insurance expert. Furthermore, my statements are not intended to support positions on the liability insurance crisis taken by the insurance industry, regulatory agencies or the various manufacturing and service industries. I offer this testimony as an environmental risk assessment expert, who has been directly and indirectly involved with all of the affected concerns for a number of years. My testimony is presented to clarify to what degree risk management can

be used to improve the insurance crisis as it exists today, specifically in the environmental impairment liability area.

As background, the liability insurance crisis is a multi-faceted problem which has its roots in a number of factors. No one of these factors, by itself, has caused the liability insurance crisis, but many of them have been related in pyramid fashion over several years to create this situation. The most significant contributing factors would appear to be:

- A Tort system which is in need of reform

- Sustained, sensationalized media coverage of hazardous and toxic waste incidents which has negatively influenced public perception.

- Unwise insurance underwriting practices during a soft market and during a period of high inflation which have resulted in significant losses.

- Inconsistent and inadequate enforcement by the regulatory community which has confused and sometimes undermined the efforts of responsible companies and has allowed irresponsible companies to gain an unfair competitive advantage.

- A regulated community which has focused on technical compliance often at the expense of sound risk management practices.

Several brief comments on each of these causes follow.

First, our present judicial system routinely hands down large damage and punitive damage awards in environmental liability, product liability, and professional liability cases brought before the court. The insurance industry understandably is reluctant to offer coverage in this climate. Consumer groups and public advocates insist on protection. The dilema is clear.

Second, media coverage of events related to hazardous and toxic chemicals and wastes, product liability, or visually spectacular releases of flammable material is often sensationalized and focuses on "what went wrong." Almost always, responsible steps have been taken to minimize the impact on the environment and the community, but are seldom presented in context. The constant negative reinforcement presented by the media ultimately affects the thinking and actions of the public, jurors, judges, insurance underwriters and reinsurers - - cumulatively affecting liability insurance. Environmental ıeporting has been called "the problem child of the media" and has spawned a new graphic vocabulary, perhaps typified by the term "chemophobia."

Third, during the soft market experienced in the early 1980s, many insurance companies competing for investment dollars wrote liability coverage based on unwise underwriting practices. Coverage was often written without adequate (sometimes without any) risk assessment, with less than qualified persons conducting risk assessments or for facilities which represented significant potential for causing environmental impairment. When claims predictably resulted and, coincidentally, high interest rates declined, the premium dollars generated were not adequate to cover the cost of claims in the climate of today's civil justice system. Although some companies followed sound practices in underwriting EIL insurance, many did not and have suffered. Only one major insurance company has survived the tightening environmental impairment liability insurance market.

In a soft market, an insurance company insisting on more rigorous environmental risk assessment prior to binding coverage would be at a significant competitive disadvantage compared to other insurance companies requiring less in-depth or no risk assessments.

Fourth, environmental legislation, regulation, and enforcement has been inconsistent and sporadic, at both the State and Federal level. Industry has been given confusing signals about what it needs to do to comply with regulations. A recent New York Times article on chemical hazards alleged that "Federal efforts to protect the public from dangerous chemicals and other environmental risks

are foundering in a confusing, contradictory, haphazardly administered mire of laws, rules and procedures, according to both proponents and opponents of greater regulation." A recent Chemical Week article points out that "The regulation of hazardous waste management in California is a hodgepodge, with 12 separate agencies calling the shots". Industry needs (and wants) clear guidelines and objective, verifiable standards upon which it can act with confidence. A major factor further confounding this problem is that technology is changing rapidly and pollution abatement and cleanup actions today will be judged by tomorrow's standards.

Lastly, the regulated community has cautiously monitored environmental legislation and environmental programs have focused on technical compliance. In general, an aggressive, proactive approach toward overall risk management and reduction has not been widely pursued. Jolted by the disaster at Bhopal, many companies have conducted country-wide risk surveys of major facilities. Considerably more effort is needed in this area.

Since the causes of the insurance liability crisis are multi-faceted and interrelated, effective solutions to this problem must also be multi-faceted. A short-term solution which has received much favorable support lately is the Kasten-Danforth proposed amendments to the Risk Retention Act. These amendments would clear the way for businesses, trade groups and municipalities to purchase commercial casualty coverage as a group or to form captive insurance

companies to pool risks. Such legislation may offer some relief by providing businesses the option to cover their own exposures in the absence of commercially available liability insurance. It is prudent to note, however, that sound risk management techniques will be even more critical for captive member companies, since reserves to cover losses will likely be limited.

Longer term solutions to the liability insurance crisis are needed. A few of the more obvious solutions include:

- More consistent enforcement by the regulatory agencies

- Adherence to sound underwriting practices by insurance companies, requiring thorough assessment of risks and exposures

- Reform of the present tort system, balancing protection of consumer rights with provisions to ensure damage and punitive damage awards are more reasonable

- Development of strong internal risk management programs within the regulated community.

What role can risk management play in relieving the crisis in environmental impairment liability insurance? By requiring more in-depth risk assessments of insureds' operations, underwriters and

reinsurers will have more confidence in decisions to provide or withhold coverage. One evolving area where the scope of an "adequate" risk assessment has not yet been defined is in assessing the risk from sudden & accidental exposures, such as the release of toxic material from a pipeline rupture. Before January 1986, such exposures were routinely covered under comprehensive general liability (CGL) policies. Typically, no risk assessment was conducted to assess environmental exposures prior to writing CGL policies. This practice cannot reasonably continue. Risk management techniques must be developed which will provide reasonable assurance that major sudden & accidental risks and liabilities are identified prior to binding coverage.

Within the manufacturing and service industries, strong environmental risk management programs must be developed to protect company assets and to minimize dependence on insurance. In addition to the traditional key elements of a strong environmental management program, such as a written corporate environmental policy statement and an environmental audit program, a truly effective risk management program must be expanded to include some form of risk analysis.

Risk analysis is a technical tool that is particularly useful in predicting the probability of successive unlikely events occurring which might result in an environmental incident. By way of example, it would be relatively simple to assess the potential for a

gas-fired home furnace developing problems which could result in a fire or explosion. On the other hand, estimating the potential for the unlikely series of events which occurred to produce a deadly gas leak at the Bhopal, India chemical plant would be orders-of-magnitude more difficult.

One use of risk analysis is to help make decisions on the type of back-up equipment to employ. In the nuclear industry, as you would imagine, risk analysis is a proven and powerful technique. Utilizing risk analysis as a tool in risk assessment appears to be in the right direction.

One potential area of concern which should be avoided is a "cookbook" approach to risk analysis which would be intended to qualify virtually anyone to conduct a risk analysis. Sound risk management practices dictate that qualified professionals are needed to provide proper judgement at appropriate decision points in the risk analysis process.

For large, complex facilities or for companies with many facilities, some form of computerized environmental system may be necessary to adequately manage environmental affairs in this era of escalating and changing environmental regulation. Several examples include emergency response systems which aid in detecting and responding to toxic gas releases; regulatory tracking systems which monitor

existing State and Federal regulations, as well as proposed legislation and regulation; and environmental information management systems which store and process all environmental information on a company's operations.

Finally, the focus of environmental audit programs must be expanded from the traditional technical compliance scope to include environmental affairs management assessments and in-depth risk assessment. This expanded focus will assure that environmental policies, procedures and programs are in-place and effective and that the operations of individual plant facilities, while in technical compliance with environmental regulations, do not pose unacceptable environmental risks or long-term liabilities for the company.

There are several positive effects which can be attributed, at least in part, to the liability insurance crisis. The environmental awareness of corporate management has increased; effective programs are being implemented, such as periodic environmental audits, employee awareness training, and hazard communications; and risk managers are being given more authority and responsibility for protecting company assets.

In closing, risk management can help to reduce exposures and liabilities for manufacturing and service industries, as well as for the insurance marketplace. It cannot, however, answer the question: "What is acceptable risk?" The public - - all of us - - must make this determination.

Mr. FLORIO. Thank you very much.

Let me, Mr. Pizzi, address you in my first round of questions and then I will go to our other two witnesses.

First of all, let me commend you for an extremely thoughtful, moderate presentation. I am very impressed with the analysis that you provided.

You talked about tort law reform. Our other witnesses gave some specifics as to what they thought should be encompassed in tort law reform. Have you got some specific areas of concern?

Mr. PIZZI. I really do not feel that I am qualified to address that.

Mr. FLORIO. AIG is the only company, apparently, that provides hazardous waste coverage to any great extent now. It has been represented to me that, in part, the reason why they do and do it apparently fairly well is because of the unique qualities and talents of their underwriters in the area of underwriting environmental risks.

Many other insurers who are in this field either do not have or do not feel they have the quality of capability in underwriting to really assess risks and therefore, they are not involved and do not want to become involved in entering into an area that is highly speculative if you do not know what the risks are.

Is there any validity to this and if there is, what is it that we are doing, by way of training of underwriters when we are coming into areas of very complex insurance risks? Biotechnology, a whole new field. How does someone get insurance if we are not training underwriters to understand the nature of the business so they can actually evaluate risks?

Can you address this whole question?

Mr. PIZZI. Sure, I would be glad to.

There is definitely validity to your comments on AIG's underwriters. In my experience AIG, for the past 3½ years, has only used underwriters with technical backgrounds. They do understand risk in the context of environmental liability.

AIG has also had a very clear plan for growth in underwriting during the past 3½ years. They have stuck with that plan. They could have very easily jumped in and expanded their growth substantially during the soft market. But they stuck primarily to their plan and they also have kept their reinsurers very well informed of where they stand on progress, relative to that plan.

I think these combinations of factors result in AIG being the only company left writing insurance today in the environmental area.

In terms of training of new underwriters, you hit on a key area. There are several things going on right now. AIG is turning to outside consultants to make presentations to their underwriters to get them more involved and better educated on the new type of risks—primarily the sudden and accidental type risks—that we would be facing.

They are also looking for underwriters that do have technical backgrounds related to the specific industries they deal in. Now one of the problems is they deal in almost all industries. There is very little choice, if you will, among industries that need environmental liability insurance. So a key problem is how do you get underwriters that are conversant in all of the areas. And the answer

is: you do not. You need to somehow get underwriters with experience in some areas and other underwriters with experience in others.

Mr. FLORIO. Is there anything to what I have heard about the Japanese launching a whole new initiative in the insurance field and starting the training of underwriters in those specialized fields, so as to be able to underwrite costs in a more effective way, and attempt to make some initiatives in the insurance field? Is this something——

Mr. PIZZI. I am not aware of anything.

Mr. FLORIO. I have some other questions for you, but I just realized that you are a constituent of our colleague, Mr. Fields. Let me yield to him at this point.

Mr. FIELDS. Mr. Chairman, I appreciate that very much. I am not sure whether Mr. Pizzi is or not, but George Pilko of Pilko & Associates is.

Just two questions, Mr. Pizzi. In your testimony, on page 5, you indicate that environmental programs have focused primarily on technical compliance. Why do you think that is so?

Mr. PIZZI. Well, primarily industry—the regulated community has been in a reactive mode, if you will, to regulations. I made the point that regulation/legislation to date has not been very consistent. What industry needs to know is what they need to comply with and how they need to do it, and assurance that if they do comply with today's regulations that 6 months from now they will not be called on the carpet for doing what was acceptable today.

So I think, in my experience, industry has been reacting to the regulatory situation and just have not focused on what I call the risk assessment areas.

Mr. FIELDS. In your risk assessment, do you primarily deal with environmental problems, environmental concerns?

Mr. PIZZI. Yes, primarily in environmental; and safety and health also come into that.

Mr. FIELDS. You point out that risk managers are being given more responsibility and authority. What do you see risk managers doing to reduce liability for the company?

Mr. PIZZI. I see this as one area in which we might see some salvation. Risk managers are doing two things. One, they are pulling together a lot of different groups within companies. In the past, engineering might not talk to environmental. They might not talk to legal. But risk managers today, in what I am seeing are pulling together the various groups to try to minimize risk to the company.

The territorial protection, if you will, is starting to fade away and I think risk managers are the catalysts for doing this.

Risk managers are also looking more toward in-depth risk assessments to uncover liabilities, realizing full well that insurance may not be available. But they still are continuing with the risk assessments that would be required for insurance. And in this way, they are getting to the risk to the company, even though they know that insurance may not be available.

Mr. FIELDS. Mr. Chairman, thank you very much.

Mr. FLORIO. Mr. Pizzi, let me just follow up on the last point. For example, when we relate this to our other witnesses, when we talked to them with regard to environmental restoration coverage.

And the point that was made, I think, by one of the witnesses was that somehow the law should be changed to eliminate that requirement and then insurance will be made available.

The dilemma I think I see is that that means the insurance provisions or the insurance coverage that will be available will not deal with the nature of the risk. Then what happens to the trucker if, in fact, there is no coverage and the event occurs? At that point, we would have a dilemma that I am sure that they will be prepared to address.

But when we are talking about coverage—let us assume for a moment we are talking about a trucking company. We are talking about a trucking company that is transporting hazardous wastes or potentially hazardous material in tank trucks. The evaluation of the risk, as to the probability of accidents, and things of that sort. That is not beyond your capability to evaluate, is it, as a risk management firm?

Mr. PIZZI. No, the evaluation of the risk is definitely within the capability. One of the things that Mr. Deragon addressed was when an inspector, if you will, goes in and reviews records he may review files for only 10 of 100 drivers and the recommendation was made that all records should be reviewed.

Directionally, I agree with that. The problem is practicality and cost. You need to have a cost benefit there. And I agree definitely with what Mr. Deragon suggested, that if you do more review and more analysis, you can more adequately address the risk and assess the risk.

Mr. FLORIO. But that is risk abatement, as opposed to evaluating what premiums should be on the basis of potential risk. Is there not—clarify if I am wrong, but are there not two levels? We are talking about enforcement of the law, enforcement of the regulations being spotty, therefore increasing the actual risk as opposed to underwriters jobs of anticipating what the risks are prior to the enforcement of the law.

That is the problem I am having with this concern about not being able to evaluate environmental risk. Somehow there is the picture being conveyed that this is so esoteric that we cannot evaluate prospectively what the risks should be.

First of all, I thought that's what insurance is about. But can you clarify if what I am talking about, the distinctions between nonenforcement of the law resulting in greater probability of an accident versus the inherent complications of trying to evaluate the environmental hazards that may be associated with transporting fuel oil in tank trucks?

Mr. PIZZI. If I may change the example a little bit, and not talk about the transportation issue per se—because I do not really feel I am qualified to address that in depth. But if you take that analogy and address it to the Bhopal situation, for instance. As a risk assessor, to assess the risk of a Bhopal-type situation happening, in order to have some degree of confidence that you have covered all the bases and have the confidence that you have done the homework and you can predict what the probability is the cost of something like that becomes much more than even the premiums for insuring a plant like that.

The problem with assessing the risk is it is a continuum. It can go from something that may be on the order of several hours worth of work to several man-years if you do the risk assessment such as the nuclear industry does when they do fault tree analysis.

And I see that coming into play here in that nonenforcement of the laws certainly creates more probability of risk. But in order to assess that risk with some degree of confidence, we need some better guidelines. And I guess "guidelines" is not the word here.

The problem comes in the cost of doing an adequate risk assessment. The market will only bear a certain cost and therefore we need some incentive to get what you might call an adequate risk assessment done. And I think cost is the biggest factor in doing that.

Mr. FLORIO. But is not the alternative insurance rates that are incapable of being paid, or no insurance at all? Have we not seen this in the area of construction insurance that—for fire purposes—that the industry has an unofficial—or maybe it is official—code. Say if you are going to build a house there has to be wiring and there has to be fire protection in such a way. And therefore, that cost is built into the product.

Failure to have that almost means that you do not get insurance, which in and of itself is an extreme cost. So we really have got to get to the point of e 'uating what the cost is of risk abatement, whether it be industi, nduced risk abatement or governmentally induced risk ab .ement.

Your example of Bhopal was an interesting one because this committee had substantial hearings on that whole area. The determination, the conclusion was, first of all we have no national regulatory system on facilities such as the Union Carbide facility. And, therefore, you do not even get to the next problem as to whether there is enforcement of the law because there is no law.

It is certainly a very difficult area that could perhaps be of some value that—filling the void could be of value to the insurance industry if we had a law that makes some effort to spell out what inspection procedures are, what the nature of the types of operations should be. Then, hopefully, if those laws were enforced, one would say that that would provide greater certainty in terms of risk evaluation, which should translate into reduced costs for insurance.

Is there any validity to the conclusion?

Mr. PIZZI. I agree with that, and I think it relates to looking at risk from a short-term perspective. What is the risk in terms of cost today? What is the risk in terms of cost to a company, to society as a whole over time? And I think you've hit on that point. We need to look at it as a long-term cost and a long-term risk and not focus on a short-term perspective.

Mr. FLORIO. Let me ask you one last question, and then I'll yield to the gentleman from Pennsylvania.

Are you familiar with the recent EPA land disposal regulations that have been put out, designed to implement the 1984 RCRA proposals?

Mr. PIZZI. In general, yes, I am.

Mr. FLORIO. The concern that many of us in a bipartisan way have expressed to EPA is that the regulations don't appear to be in

compliance with the intent of the law, which is to effectively say that there should be no disposal of untreated wastes in land disposal facilities, the sole exception being a petition that certifies that there is no migration off the site. The regulations have come back, and they almost appear to be the direct opposite of that.

As someone that might be consulting or representing an insurance company trying to make the determination as to whether to insure a land disposal facility, would you enter into or provide any counseling to an insurance company that under those circumstances that they would be wise not to become involved in that type of insurance risk?

Mr. PIZZI. OK. First of all, we don't advise the insurance companies on whether to insure or whether not to insure. What we do is advise as to what the risk would be, and our focus is primarily on risk and not compliance.

Mr. FLORIO. Risk.

Mr. PIZZI. So in that situation, whether or not a facility is in compliance is almost immaterial. We look at the risk and liability of a company's actions or a facility's actions.

Mr. FLORIO. Well, if I represented to you that as a matter of national policy, overwhelmingly this Congress has said in the 1984 amendments that we want to phase out over a very short period of time, a relatively short period of time, the disposal of untreated hazardous wastes into land. That, I would suggest to you, is a policy decision with regard to the reduction of the risk that we calculate exists from continued disposal of these wastes in the land.

I suppose I would ask then, understanding a little bit better what your company does in advising people with regard to risks, given the current situation, I am an operator of a land disposal facility. I want to continue to operate as authorized under the law, and yet we have this law that says that we're going to start phasing out certain types of disposal, and we have a regulatory system that is under challenge for doing the very opposite of that, what is the nature of the type of advice that you provide to make the determination as to whether insurance should or should not be provided to that operator?

Mr. PIZZI. We would make two recommendations. One, to the landfill operator, and our advice would be to look at the long-term liability and the long-term consequences of what he's doing and suggest that he comply with the intent of the law and not focus primarily on what the particular regulation may be today, but to look at his liability and the risk on a long-term basis and make kind of the same recommendation to the insurance company, that the risk of claims, the risk of environmental impairment from the facility would be higher than if the facility was targeting their program to comply with the intent of the law.

Mr. FLORIO. Thank you very much.

Mr. Ritter.

Mr. RITTER. Thank you, Mr. Chairman.

I would like to just continue for a moment with you, Mr. Pizzi.

I've been a strong supporter of the use of risk assessment in the process of setting health, safety, and environmental standards and rules and regulations, and even in the creating of the law that outlines the regulatory field in different areas.

But so much of the law, the regulation, and the rule is not based on risk assessments. So much of it is based on current political, often emotional climate. The liability grows out of this nonrisk assessed structure of the rules, the regulations.

How can you advise customers as to the risk when court decisions are rarely based on rational risk assessments?

Mr. PIZZI. I guess I have to agree with your reference to the court decisions. That's obviously an area we need to improve.

The advice that we can give is strictly from a best judgment—I need to make the point that risk assessment is, in fact, a subjective judgment.

Mr. RITTER. You're not talking about scientific risk assessment here. You're talking about a very encompassing—is that what you're talking about?

Mr. PIZZI. Yes.

Mr. RITTER. So it's not just a technical risk assessment, but it's all factors included, social factors.

Mr. PIZZI. Yes, exactly.

Mr. RITTER. Political, economic.

Mr. PIZZI. Exactly. And when you do a risk assessment in that way, it becomes very subjective. It is based on the person or persons making that assessment, calling on their experience and on the best technical guidelines they can call on, but it is nonetheless very subjective. And the way that you advise companies is to use your best judgment and look again at the long-term risk and not focus on compliance with a particular law today that may necessarily—or may not necessarily—keep you out of trouble tomorrow. You always focus on the long-term risk.

And I'd like to go back and pick up on the front part of your question. Our clients are not at all concerned with enforcement per se. What they are concerned with is not having clear guidelines to go on, no yardstick to judge their actions. They would welcome something that would give them some assurance that what they do today, 6 months or 2 years from now will be acceptable, or at least they will not be called on the carpet for doing what is acceptable today.

Mr. RITTER. I was not here while you gave your testimony, but do you feel that the current system, the system in the courts, is functioning properly, or would you wish to see reform?

Mr. PIZZI. Without being qualified to address specifics, I definitely think we need some sort of tort reform. I'm certainly not qualified to go into detail or say how much. But the cases that I have experienced and known about, I definitely feel there is room for reform of the tort system.

Mr. RITTER. There's a question here that I'd like to ask that our colleague, Mr. Broyhill, is very interested in.

Mr. Dameo, May Trucking Co. has filed petitions to self-insure with both the ICC and DOT. Do you know how these petitions are proceeding?

Mr. DAMEO. To my personal knowledge, I do not. I know they are in process. But I have Lana Batts here, vice president of the American Trucking Association. I think she has the answer.

Mr. RITTER. Thank you.

Ms. BATTS. Currently both DOT and the ICC have those petitions under advisement. It is our feeling that the ICC is going to act quickly on the May petition.

The problem that May then has, of course, is that the DOT has no rules or regulations regarding self-insurance, although the Motor Carrier Act of 1980 did allow self-insurance. DOT is in a quandry: They really can't accept the petition and they can't deny the petition, because they have no way to judge the validity of the petition.

What is probably going to happen is that DOT will go to rulemaking, which will be a long process. They'll establish the criteria for self-insurance and then deny or accept the May petition.

Mr. RITTER. What kind of timeframe are you expecting?

Ms. BATTS. Within the ICC, we're probably looking at something within a month or two. Within the DOT, it's certainly going to take much longer, 4 or 5 months.

Again, what we're trying to create are options. At this point, there is no way of knowing whether the May proposal is good or bad. We're hoping that, at least, the option will be created, so that the industry can get what the law provides, that is to self-insure.

As Mr. Dameo's testimony indicated, the ICC in the last 20 years, and actually I think it's been closer to 30 years, has never allowed self-insurance.

Mr. RITTER. Do you have any insights as to how the DOT is going to respond to this, whether they will go ahead?

Ms. BATTS. My educated guess is that they will ultimately allow; however is for carriers on self-insurance. That ruling will be very stringent, but reasonable. We are not seeking to allow anybody to self-insure. What we want to make sure is, though, that the guys that have the financial ability to self-insure.

I have a favorite truck line. I call it "Quicksand Trucking." This is a guy who's ready to go broke tomorrow. He should not be allowed to self-insure. We're looking for viable concerns that are going to be around, who have the understanding, who have the safety programs. They should indeed be allowed to self-insure, just as their competitors, the railroads, are.

Mr. RITTER. Well, broadly speaking, we're saying that the survivors are going to be those whose pockets are relatively deep, and smaller businesses that maybe are just starting up and don't have that kind of financial background are going to be hardpressed indeed to engage in any area that has these kinds of rigorous insurance requirements.

Ms. BATTS. Self-insurance will not be limited strictly to large companies. We're talking about companies that can meet the Federal minimum level. That doesn't necessarily mean a large company.

What self-assurance will do, though, is to increase capacity in the markets. On face value, we're going to assume that if certain trucking companies are self-insured, then their capacity will go to other trucking companies and not to some other industry.

Mr. RITTER. Will the expansion of the Product Liability Risk Retention Act help some of the small businesses?

Ms. BATTS. We haven't taken a formal position on either of those two, although we're certainly enthused about what both of those would look like.

Again, the trucking industry will seriously consider anything that creates options, or creates capacity. While either action doesn't solve the insurance crisis, it does increase the capacity and the affordability.

Mr. RITTER. Mr. Chairman, if you would bear with me, just one final question on this matter.

Is it possible that if self-insurance is broadened, there would be less pressure in the claims area, less demands for major awards. Would the price of the damage suits go down?

Would the courts look differently on self-insurance as opposed to deep-pocketing insurance companies?

Ms. BATTS. I seriously doubt that. I mean, the claims will be made one way or another. That's why if anybody does self-insure, they're taking on a tremendous financial risk to their own company. I don't see that the courts are going to look at it one way or the other.

Mr. RITTER. But isn't part of the problem today that juries have been making very substantial awards with the idea that there is a deep pocket, and the awards are affordable by a multibillion dollar insurance company, and if they see a small trucking company out there self-insured, are they going to behave differently? Is there some anticipated change?

Ms. BATTS. Yes; but that small trucking company will still have to meet the Federal minimums, which by most standards are deep pockets: $750,000, $1 million or $5 million dollars. Claimants will know beforehand what the statutory minimums are. Incidentally the majority of claims against the trucking industry, as recorded by the BMCS, the Bureau of Motor Carrier Safety has, were for less than $500,000.

So, judges already know what the minimum levels are. Whether a trucking company is large or small, it has to meet Federal minimums, which already are very, very high.

Mr. RITTER. Thank you, Mr. Chairman.

Mr. FLORIO. Let me address a couple of questions. In your tort reform proposal, you raise the question with regard to punitive damages. Some don't make a distinction between punitive damages and damages for pain and suffering. Some distinguish and some don't.

Can I ask what your thoughts are as to how you're defining punitive damages?

Mr. DAMEO. We're considering that as part of the pain and suffering and part of a total package that every claim does not entitle itself to punitive damages. That was supposed to be a restrictive measure to put a penalty on people for intentionally doing things wrong. If that was not the case, then punitive damages should not be imposed.

Mr. FLORIO. The only distinction I would make is that pain and suffering is not traditionally regarded as punitive damages. There is a separate category of damages, punitive damages, so that as we discuss, as we undoubtedly will in the Congress and across the Nation, restrictions on tort law recoveries, we all ought to keep in

mind the distinctions between them. If we're going to be advocating total elimination of pain and suffering as well as total elimination of punitive damages, that's fine, but just so that we know the difference between the two areas.

Let me ask the major question I'm interested in, and you raised it with regard to the coverage in section 30. As I understand, what you're stating is that if there was a change in the law so as to eliminate the need for insurance coverage for environmental restoration damages, that somehow you think that your insurance rates would come down or insurance would be made more available.

I can understand that only if you concede that the insurance would come in but would not cover the types of damages that may flow under the definition of environmental restoration, which, of course, would leave the truck operator with no coverage, and in the event of an accident or an occurrence, may well drive him to the bankruptcy courts.

So that how are you better off merely by virtue of a legislative change defining what it is you're required to have when one would assume a responsible truck operator would want to have the coverage that would be required to hold them harmless in the event of a tank truck explosion that might involve environmental damage?

Mr. DAMEO. Prior to 1980, these damages were covered under the property damage clause. When they inserted the words "environmental restoration," the courts, unfortunately for New Jersey, in the *Jackson* case interpreted that much broader than was ever anticipated. That interpretation of the landfill was taken up by the insurance companies and applied to this environmental restoration clause of the trucking company in section 30.

That court case, coupled with the potential damage, which would have been covered under the long-tail coverage under property damage if we stay under the occurrence-made based insurance, would still be covered. By removing that section, it takes that whole wording out and reverts back to what we did prior to 1980 where all those cases were covered and handled at that time.

Mr. FLORIO. And you think that by changing that law that we are going to go back to that point, that the insurance companies are going to provide you with property damage coverage to go into areas beyond what they are talking about now as merely property damage coverage?

Mr. DAMEO. It's a start in the right direction, yes. Their opinion was that it would.

Mr. RITTER. Would the gentleman yield on that point?

Mr. FLORIO. Yes, I will be happy to yield.

Mr. RITTER. I think there is a fundamental difference in the definition between property damage and environmental restoration. I think maybe it hinges on that.

Mr. FLORIO. If the gentleman would yield, the gentleman is correct, it clearly is. My point is that if somehow mechanically we are going to legislatively define property damage so as to provide for insurance coverage only for that, that is fine for the insurance company—they are limiting their risks—but it is not fine for the trucking company. They are now out there bare of insurance coverage for what is something that I think most trucking companies would want to have.

Mr. DAMEO. We are not suggesting going bare.

Mr. FLORIO. Then you are going to have to get supplemental coverage in ways that I suspect you are not going to be able to get it, or you will get it at a very high price.

Mr. RITTER. Could we just follow up on that?

Mr. FLORIO. Yes, surely.

Mr. RITTER. I think the gentlelady has a comment here.

Ms. BATTS. We have had environmental restoration coverage since 1980 required by the Motor Carrier Act. As far as we can determine, there have only been three claims made under environmental restoration since 1980, and they were in 1981 and 1982. Unfortunately, we have had more than one truck spill since 1980. Those claims, in terms of cleaning up the environment, in terms or removing topsoil, in terms of cleaning up streams, were paid under the property damage and the bodily injury clauses of the current insurance policies that we have.

They are not being cleaned up under environmental restoration. The problem with environmental restoration is, first, it was never defined by Congress in the Motor Carrier Act of 1980. It was defined by the Department of Transportation. Second, the definition that the Department of Transportation has talks about potential future human harm. How in the world can you expect an insurance company to underwrite something called potential future human harm when the claims can be made today on some kind of harm that someone may have 30 years from now.

But we are cleaning up the environment when we do have those unfortunate truck accidents.

Mr. RITTER. But the chairman's point is that you could get sued anyway. Is it correct that you could get sued anyway for potential future human harm even if it is not written into the statute?

Ms. BATTS. It is not written in the statute today; it is written in the regulations. Ideally, we would like to see the regulation definition changed. Given the current court system, we are not terribly confident——

Mr. RITTER. But what the chairman is asking is does the change in the regulation definition——

Mr. FLORIO. Bring you anything.

Mr. RITTER [continuing]. Preclude suit against you for potential future human harm?

Ms. BATTS. It probably doesn't, but at least it isn't sitting in a regulation which says that is what you are supposed to be covered for.

Mr. RITTER. That is, I think, the bottom line. By spelling it out, you have a written definition, you have, in a sense, a target, you have a home base to gather around. Is that what you are saying?

Ms. BATTS. Correct.

Mr. RITTER. And this is what engenders the fear in the insurance companies that have to deal with this thing.

Ms. BATTS. That is correct, but the point I want to be making is that we are——

Mr. FLORIO. The gentleman's point is a very helpful one, but also—and you have made the point in some respects—notwithstanding the statute, notwithstanding this regulation, that there have been no claims under it, that there has therefore been no loss

payout, and therefore there is certainly no justification for the unavailability of insurance on the basis of the experience even in this area.

I return to my question, and I suppose my conclusion is that a responsible truckowner and operator is certainly going to want to have insurance for potential losses in this area as well as in other areas, and the idea of potential injury being difficult to insure against, that is done every day in every field that we are talking about, not just in terms of environmental restoration.

Your workers come, and it may very well be that they are loading up gasoline trucks, and you certainly have insurance against potential future harm, whether it be catastrophic harm or whether it be incremental harm occurring as a result of worker exposure to these types of things.

So there is nothing particularly unique about this except for the point that you are making, that some feel that by signaling this, that everyone is now, whether it be wily plaintiffs' lawyers, out finding new causes of action to run into court with. I just think the experience has not been there to justify that conclusion.

Mr. DERAGON. On this issue, currently over 75 percent of the insurance companies writing trucking will provide the MC90 endorsement, which does state you must require environment restoration. However, right next to it they are providing an exclusion which says we will not cover anything related to pollution, contamination, or whatever.

So the issue is, if the trucker is required by statutes to have the coverage but he can't buy it, you are asking where is he going to get the protection? He is in violation of the regulations under the ICC. Currently, if the product is not available from the insurance industry, where does it go. We may have a major catastrophic accident out there with no coverage, and the public will turn to the Government.

Mr. RITTER. Mr. Chairman, I would just like to get the gentlelady's response to the chairman's point, which I think is well taken, but if there has been only three claims, what is the problem and why can't they get insurance? I guess that is the bottom line.

Ms. BATTS. Again, it goes back basically to the term "environmental restoration" which is the same term that was used in the Jackson Township case in New Jersey, to define "sudden and accidental" and "per occurrence." The definitions are spilling over into the trucking industry because it is the same language.

The difference with workmen's comp is that you can't make a claim today when you haven't had anything happen to you, but you are saying it may happen to you in the future. Under the "environmental restoration" definition of the Department of Transportation, I can make a claim today on something that may materialize 30 years from now. That is what the insurance industry does not want to have to underwrite. They can deal with something which actually happens, but they cannot deal with something called potential future human harm. They don't know what it means.

Mr. RITTER. Why haven't more claims been made? And if it is only three claims, why isn't the insurance available?

Mr. DERAGON. They are scared of the courts.

Ms. BATTS. They are scared of what the courts are doing in the dump site problem in Jackson Township. They are then saying, that if the trucking industry has the same kind of coverage, we may end up with the same kind of claims in the trucking industry that we ended up with in New Jersey. Therefore, they are not going to write it.

Mr. RITTER. So on the basis of one or two or three claims, they are making this value judgment.

Ms. BATTS. No, they are not making it on the basis of the claims that were paid in the trucking industry; they are making it on the basis of the court suits in another industry with the same definitions.

Mr. RITTER. OK. Where there are substantial numbers of claims made.

Ms. BATTS. That I don't know.

Mr. RITTER. Well, that is what I'm asking.

Mr. FLORIO. May I just add one thing? Much has been made of this Jackson Township case, and quite frankly, it is a handy hook to hang one's hat on if one doesn't want to insure in a whole area, but the gentleman's point about multiple claims, there have not been multiple claims even in the other area that have resulted in anything. We have had evidence before this committee, and again, it is the same type of almost irrational speculation about the potential source of difficulties at some point in the future.

I would just suggest that when you make the point that in the insurance area with regard to trucking, that somehow there is a unique problem because of future potential off of an incident you can file on now, that too is not that difficult, but if an employee is injured today, he can make a claim and does make a claim and includes it as a count for damages for future potential injury growing out of the event that occurred now.

Likewise with regard to a trucking incident, an accident occurs, the claimant can make an action for future potential damages growing out of the incident now. So there is conceptually nothing different in these areas that would prompt some legitimate concern about uniqueness here that is not found in the nature of litigation, that is not found in the nature of insurance claims anywhere.

Mr. DERAGON. Currently there is a case, as an example, involving a trucker going through a small town in Louisiana, population 6,500. The trucker jackknifed and dumped a load of petroleum into the town water. The court ruled that his policy at $1 million, combined single limit, would apply to each individual resident of that town per occurrence claim in the current or future. So, 6,500 times $1 million is what the insurer says, oh, my God, we didn't realize that we were going to be on this.

Now, that is being appealed, but you can understand why the insurers are reacting, because of instances like this.

Mr. FLORIO. That is a very good point, and it seems to me, and this was the holding in the Jackson case, that the insurance companies are going to have to start being more specific with regard to the terms of the insurance policies, and if there is ambiguity—and there is no excuse for this now, after Jackson—if there is ambiguity with regard to occurrence defined, shame on the insurance com-

pany; that they write the contracts and therefore they should be defining those terms in terms of what constitutes an occurrence.

So I am really not sure that there is any legitimacy about the industry's concerns about the Jackson Township case, and there should be no concern about that in terms of defining what is an occurrence now.

Mr. RITTER. Mr. Chairman, I think in some of the approaches of claims made, the insurance companies are trying to do something about that, but I also think that, given the system, it may be a Herculean task to arrive at that policy which can somehow wire all possibilities given some of the broad language that exists in the law.

I think the law or the rules and regulations are so much more encompassing, the system allows so much more an encompassing approach, that to then try to use the contract as somehow the wedge against the whole system may be asking for too much. I think you are right. I think they have to put greater effort and planning and intelligence into defining the contract, but that may be asking for the impossible given the way the system is set up.

Mr. FLORIO. Let me ask one last question of Mr. Deragon. In the area of risk management, particularly in the trucking industry, the suggestion has been made to us that more could be done either by governmental enforcement of safety laws or by insurance company enforcement of safety laws in the absence of governmental enforcement: The question of front end brakes, the question of the underride regulations, that either the Government enforce those regulations, and if the Government doesn't enforce them, as is the case now—you talked about the difference between ICC and DOT. Well, on the front end brake question, there is a difference even within DOT as to whether the rules are to be enforced or not.

Absent vigorous enforcement by agencies, isn't there an appropriate role for the insurance industry itself to play in conditioning coverage upon certain activities, hooking up the front end brakes, changes in the underride structure? Those types of changes would abate risks or minimize risks, which certainly should provide the insurance company with the capability of downsizing the premiums to reflect the reduced risks.

Mr. DERAGON. That is an ideal management practice that the insurance industry should be practicing. In a soft market, what is known as the preliminary survey is never done on a risk. The agent throws the application in on a napkin, and they write it because they want the volume. In today's current environment, out of the companies currently writing transportation risks, still probably only half of them actually send out a physical inspection on that risk before they agree to write it.

Mr. FLORIO. Doesn't that say something about the adequacy of our State regulatory systems, that if the premiums are not being set at an appropriate level, it is hard, I suspect, to come in and say the premium should be higher because you have not evaluated the risk, but ideally that is the way the system should operate, that there should be risk management or risk abatement by the insurance industry in fixing their premiums.

You say that in the soft market such as we had at the end of the seventies or the eighties, when everyone is more interested in com-

peting for the dollar for investment purposes than they are in setting the appropriate level of the premium to reflect the risk, there is nothing that is on the horizon that is going to change that the next time we go into that part of the cycle, is there?

Mr. DERAGON. Exactly. And the other issue is that motor carriers are a unique breed of risk. With very few insurance carriers having a thorough understanding of those risks, to send a qualified person in to analyze those risks is a very difficult thing to do when you don't have qualified staff or you are not used to underwriting truckers, so to speak. As we see in a soft market, everybody falls into the game.

Mr. RITTER. Will the gentleman yield on that point?

Mr. FLORIO. Let me just make this point and I will be happy to yield. The gentleman from New York, Mr. Lent, and a couple of other members are talking about risk retention for group insurance, self insurance, and there may be some value in that approach from a number of standpoints, not the least of which is that the industry or the groups of industries would have the unique capability of understanding trucking in a better way than would an insurance company that insures a great number of different industries.

That would allow the self-insurers, understanding the nature of their business and the risks in the business, to perhaps underwrite in a more sensible way, saving the self-insured consortium costs because the risks were understood and factored into the premium-setting process. Is that an acceptable point to you?

Mr. DERAGON. There is no supervisory committee or regulations telling insurance carriers or risk retention groups or self-funded groups that you must follow these practical, prudent management guidelines in your underwriting process.

Mr. FLORIO. We are working from self interest. If we had a self-insurance group of truckers wanting to reduce their risks and reduce their insurance premiums that they pay to themselves as the consortium, there would be the economic interest in not only minimizing risks beyond what, hopefully, they are trying to do anyway, but there would be the specialized capability of understanding the nature of the risks and therefore fixing costs to take into account abatement procedures.

Mr. DERAGON. This is true. However, you have truckers out there who are very good risks and have practiced proper risk management. And again I must reiterate, under the Risk Retention Act, I'm not sure you are going to get away totally from the whims and cyclical changes of the insurance industry just because a group decides to set up a self-insurance fund or a captive.

Whatever the regulations may bring, it is going to require some supervisory ability from the State or Federal level, and you may have the play of the reinsurer. I will give an example. A trucking company needed $1 million worth of coverage. He took a $900,000 deductible, and his premium was still $1 million. It is almost like a self-insured risk retention group, but the reinsurers have set the aggregate rates.

So the qualification of an insurance company to go after a diversified number of businesses is really a problem because nobody really understands every business operation and its individual risk. It is a very specialized field, and especially insurance carriers have

gotten into the motor carrier industry and insured them for many years and practiced risk management with those, but they are at the whims of the reinsurers, still.

Mr. FLORIO. Thank you. Let me express my appreciation to this panel. It has been extremely helpful to us. I appreciate your participation today. Thank you very much.

We will now call our last panel of witnesses. We appreciate their patience. Burton Thomas, the Chairman of the AIA Liability Task Group of the American Institute of Architects; Mr. William Reed of the National Association of College and University Business Officers; and Tom Hitselberger of the Arcadian Corporation here representing The Fertilizer Institute.

Gentlemen, I appreciate your presence here today. We will be pleased to hear from Mr. Thomas.

STATEMENT OF BURTON W. THOMAS, CHAIRMAN, AIA LIABILITY TASK GROUP, THE AMERICAN INSTITUTE OF ARCHITECTS; WILLIAM REED, ON BEHALF OF NATIONAL ASSOCIATION OF COLLEGE AND UNIVERSITY BUSINESS OFFICERS; AND TOM HITSELBERGER, ON BEHALF OF THE FERTILIZER INSTITUTE

Mr. THOMAS. Thank you, Mr. Chairman.

My name is Burton Thomas, a member of the American Institute of Architects, a practicing architect from Concord, NH, and the Chair of the Architect's Liability Task Group.

On behalf of the 49,000 members of AIA, we welcome this opportunity to testify before you this morning.

Liability is a complicated and broad based problem. Because owners and in these litigious times, building users can look to architects for redress. The premiums that we pay are relatively twice as high as those charged physicians.

Member firms in the Institute have seen increases in premium rates vary from 200 to 1,000 percent over the last 18 months. Today, virtually 25 percent of all firms are going bare as a result of these increased premiums.

We recognize that liability is a societal and legal problem as well as a professional one. The issue is complicated and to facilitate your deliberations, I ask permission to submit for the record two special issues of the AIA's Newsletter, a survey of the insurance industry, and an article which I wrote for Architectural Technology Magazine.

Mr. FLORIO. We will be pleased to receive it.

Mr. THOMAS. The cyclical nature of the insurance industry and the civil justice system have helped create a liability insurance crisis that is beyond the capability of architects to attack directly. Instead, we are working on more manageable aspects of the problem as it relates to the public, our clients and the profession.

Architects by nature are problem solvers. We cannot solve this problem without your help. There is one aspect of the liability problem which is especially troublesome, the retainment and removal of asbestos.

We support your efforts, Mr. Chairman, and have several recommendations which we feel will strengthen your bill, the Asbestos Hazard Emergency Response Act of 1986. Traditionally, architects

have been leaders in addressing issues regarding buildings. Much of our efforts in recent years have been in the reuse and preservation of older buildings, almost all of which contain asbestos to some degree. Now the insurance companies have excluded asbestos across the board. We can no longer buy protection for exposure to enormous risks. Consequently, many architects are unable to fulfill what we see as our complete professional responsibility to our clients and the public.

It is a very difficult feeling to stand in a building with your client and say to them when you see the presence of asbestos containing materials, I simply can't help you until you take care of that problem.

If there were one Federal standard of care for the removal and abatement of asbestos, the insurance industry might get back into the business again. If there were one Federal standard of care, people would know what to do with asbestos and how to do it. The abatement team's performance could be judged. People could be properly trained in accordance with these standards and we believe that then the insurance industry could be attracted back into providing coverage.

Standards of care ensure a degree of certainty and as we know, the insurance companies insure certainty, not risk.

Mr. Chairman, your bill is a fine first step in this direction. We commend you for taking the initiatives toward solving this pressing dilemma. It would require EPA to squarely face their responsibility in dealing with asbestos.

However, the National Institute of Building Sciences is soon to release a very detailed set of guidelines on abatement procedures. Guidelines which have been developed by representatives of EPA, AIA, the Safe Buildings Alliance, various insurance groups and others.

The AIA recommends that you require the EPA to adopt this as the Federal standard of care within 30 days of enactment of your bill. We see no reason why EPA should have to reinvent the wheel and take 180 days to do so. By spelling out standards on how asbestos is to be abated, by whom and by giving those standards the force of law, EPA could finally move ahead with effective enforcement procedures and eradicate the horrors now associated with improper abatement.

More can be done. We notice in your bill no explicit role for the architect. We are committed through our training and registration to protect not only our clients' interests but the public health and safety. We coordinate the various parties and trades which are involved in the building industry. Abatement usually involves modification to existing building systems or introduction of new materials to perform the function which the asbestos containing materials previously performed.

This total management of the process is what we do. The total management of abatement is critical to the long-term success.

Finally, your bill deals with schools. This is certainly an egregious problem but asbestos is not unique to schools. EPA estimates that there are over 700,000 other buildings which contain asbestos in the United States and that says nothing of residences. We urge

you to extend the licensing requirements of this legislation to include work done on these buildings as well.

Mr. Chairman, insurance cycles come and go and society withstands them never for the better. With asbestos exclusions, however, the insurance industry has produced something that is absolutely unprecedented. Your bill with our suggested amendments would provide the necessary first step in getting the insurance industry to once again fulfill its duties and obligations to society.

Again, Mr. Chairman and members of the subcommittee, thank you for your efforts and the leadership you have demonstrated on this issue. I welcome your questions.

[Testimony resumes on p. —.]

[The prepared statement of Mr. Thomas and attachments follow:]

STATEMENT OF

BURTON W. THOMAS, AIA

ON BEHALF OF

THE AMERICAN INSTITUTE OF ARCHITECTS

Mr. Chairman and members of the subcommittee, my name is Burton Thomas of Burton W. Thomas Architects in Concord, New Hampshire. I am a member of the American Institute of Architects and currently serve as chair of the AIA's Liability Task Group. The AIA deeply appreciates this opportunity to discuss the rising cost and frequent unavailability of liability insurance.

As this subcommittee is well aware, the liability problem affects all aspects of our society, including professionals such as architects. Because owners, and in these litigious times any building users, can look to the architect for redress, the liability premiums we pay are relatively twice as high as those charged physicians. Most architects' premiums have at least doubled, often tripled, over the past eighteen months. Over a quarter of the firms in the country are "going bare" as a result, and that number is increasing all the time.

The liability insurance crisis has been studied intensively by the Institute. The issue is complicated, and to facilitate your deliberations, I ask permission to submit for the record two special issues of the AIA's newsletter, a survey of the insurance industry, and an article I wrote for Architectural Technology magazine. We recognize the insurance industry is internationally-based and that, as such, it would be difficult to regulate it effectively from here in the United States--Lloyd's of London cannot be commanded to continue to offer reinsurance where it chooses not to do so. The McCarran-Ferguson Act further removes the industry from the realm of federal regulation. Several states have taken positive steps towards trying to curb some of the extreme peaks and valleys the industry experiences on a cyclical basis.

The insurance companies are not, of course, the sole source of the problem. The civil justice system in this country also presents problems. In 1985 almost half the architects in the country were sued. In fewer than a tenth of these cases did architects have to pay damages. Ninety-five percent of all architectural firms are small businesses, and the legal costs of proving innocence can be crippling to the individual firm.

Disarray in the insurance industry and the civil justice system have combined to create a liability insurance crisis that is beyond the capability of architects to attack directly. Instead, the AIA has chipped away at more manageable aspects of the problem as it relates to the public, our clients, and our profession. The AIA is supporting initiatives to include design professionals under the protection of workers' compensation laws, to expand architects' rights under lien laws, to lessen the amount of unnecessary litigation, to revise licensing statutes to prohibit the practice of architecture by non-licensees, and to enact reasonable statutes of limitations for design professionals.

We are not asking that the liability crisis be resolved without our efforts or our involvement. Congress might be able to adopt some type of model tort reform, and perhaps the excesses of the insurance industry's investment practices might also be curbed at the federal level. In point of fact, however, there will always be torts. We at the AIA are doing what we can to protect the public health, safety and welfare, reduce risk, and improve our own practices.

There is one area of practice, however, in which our profession and the American public urgently needs your leadership, Mr. Chairman: the containment and removal of asbestos. Architects have traditionally written the specifications for the

abatement of asbestos already present in structures. This job comes up naturally as part of the rehabilitation design of a building, and architects have therefore developed an expertise for supervising abatement in a safe and thorough manner. But now the insurance companies have excluded asbestos work from coverage across the board. This is done despite the fact that an architect has never been found guilty of improperly abating the material. The insurance companies are understandably scared of asbestos as a result of Johns-Manville type product liability cases. Asbestos abatement seems an equally unpredictable business to them, both at the rehabilitation site and in the courts. There currently is no federal standard of care for the removal and abatement of asbestos. Whatever we may say to persuade insurance companies of our competence in this area, they will not budge without statutory direction in the manner in which asbestos should be abated. Were there one standard of care, the insurance industry might reconsider their exclusion of asbestos coverage. If that one standard of care were accepted by the federal government, they just might get involved in the business again.

Were the federal government to enact a standard of care, people would know what to do with asbestos and how to do it. The abatement team's performance could be judged: were the standards adhered to or not? People could be trained properly in accordance with these standards. Competence could be demanded and monitored. It is our belief the insurance industry could then be attracted back into providing coverage. Standards of care would ensure a degree of certainty and, as we all know, insurance companies insure certainty, not risk.

Mr. Chairman, your Asbestos Hazard Emergency Response Act of 1986 is a fine first step in this direction, and we commend you for taking the initiative towards solving this pressing dilemma. The Environmental Protection Agency has been

ducking their responsibility, and their track-record to date does not suggest hope for the future. Your bill would require them to face that responsibility.

The National Institute of Building Sciences is soon to release a very detailed set of guidelines on abatement procedures. Representatives of the EPA, the AIA, the Safe Buildings Alliance, various insurance groups and others have spent countless hours developing this guide. The AIA recommends that you require the EPA to adopt it as the federal standard of care within thirty days of enactment of your bill. The public safety demands this type of "hammer" solution. There is no reason for the EPA to spend 180 days reinventing the wheel. By spelling out standards on how asbestos is to be abated, and by whom, and giving those standards the force of law, the EPA could finally move ahead with effective enforcement procedures and eradicate the horrors now associated with improper abatement procedures.

Moreover, once these standards are in place, states can train and certify people to implement those standards. People so trained and certified would then have a defense if they adhere to the standard. They would be able to say 'Ladies and Gentlemen of the jury, that was the standard of care, and I followed it. I was not negligent.' A certain predictability would be restored to the asbestos abatement industry. The insurance industry could reenter a market that has been re-stabilized by such action. Reputable, qualified design firms would no longer have to put their practices on the line in order to fulfill their professional obligations to their clients and the American public.

More, however, can be done. We notice that in your bill there is no explicit role for the architect. The removal and abatement of asbestos should be handled

by qualified people with enough experience and commitment in the area to do the job safely. This dedication of skill and training is equally as crucial in the management of an abatement plan. The architect is by training uniquely qualified to manage this process competently and safely.

Finally, your bill addresses the issue of asbestos in schools. Over 30,000 schools across the country are infested with asbestos, and this is certainly a devastating problem that must be resolved. But the asbestos problem is not unique to schools. The EPA estimates that there are 730,000 other buildings in the country, both public and commercial, that contain asbestos. Nobody knows how many residences are also affected. We urge you to extend the licensing requirements of the legislation to include work done on these buildings as well. The health hazards of asbestos are most extreme with children, but are certainly not limited to them. Millions of building occupants and users are threatened by inadequate, incompetent abatement procedures. Whether they be veterans in VA hospitals, GS clerks in an old Navy building, or a tourist in the U.S. Capitol, the safety of these people must be our paramount concern.

Mr. Chairman, insurance cycles come and go, and society withstands them, never for the better. With asbestos exclusions, however, the insurance industry has produced something absolutely unprecedented. Your bill, with our suggested amendments, would provide the necessary first step in getting the insurance industry to once again fulfill its duties and obligation to society.

Again, Mr. Chairman, members of the Subcommittee, thank you for your efforts and the leadership you have demonstrated on this urgent and pressing issue. I thank you for your time and look forward to answering any questions you may have.

Memo

See page six for practice tips

Special Issue of the Newsletter of The American Institute of Architects December 1985

Dear Colleague

Last June our national convention identified professional liability as the priority issue for the Institute You also asked us to deliver a progress report by Grassroots Knowing your concern and the difficulties facing our profession we are working overtime to get this report into your hands ahead of schedule

Professional liability was first flagged as a critical issue last winter when it became clear that our insurance carriers were plunging into one of the down cycles that characterize their industry What was unusual about this cycle was the severity and the speed of the drop

If you re like me you want definite answers Yet what s happening to us in the insurance industry and in the courts is as mystifying as it is frustrating What does it mean for the profession? And what can we do both collectively and as individuals to weather the current storm?

One thing is clear There are no quick fixes For the near future tort reform is not in the cards Nor is it likely that an imperfectly and unevenly regulated insurance industry will change overnight—certainly not in time to help us now when we need all the help we can get

Nevertheless it is also clear that reforms within the legal system and the insurance industry are important long-range goals As a first step toward achieving these goals I have asked nationally recognized experts from the legal community and the insurance industry to answer the questions you have been asking us I am sharing their answers with you because they bring a perspective and an expertise from which we can learn and on which we can base new actions

If the courts and the insurance industry itself offer little in the way of relief at this time what recourse do we have? We have ourselves

As the charts on the following pages show most of the claims against us are from our clients and contractors Clearly it is up to us to protect ourselves through better documentation contracts and client-architect relations These improvements must include detailed definition of the scope of the work the use of AIA Documents B141 and A201 and meticulous project files Together these are the basic and essential building blocks of a quality assurance program

The fact is each of us insures ourselves We do so in two ways The standard of care we show on the job is our first line of defense but failing that our deductibles are a form of self-insurance Looked at this way the insurance companies are merely back-up reinsurers

Does this view seem overstated? It won t once you realize that however tightly our premiums are squeezing us it's the repeated demand on our deductibles that can drive us into the ground That is the double wallop none of us can afford Put another way it is much easier and more within our power to avoid losing in court than it is to get insurance companies to roll back our premiums

Of course we will continue to pursue the long shots of tort reform and alternative insurance packages We owe it to ourselves to exhaust every possibility as we try to create a future less tied to the ups and downs of business cycles

At the same time we have to develop programs and strategies that work today This means we must be even better architects To that end we have condensed 120 pages of transcripts and incorporated the result into this special issue of the Memo In the following pages you will find the latest and what I believe are some of the best suggestions about how we as individuals as members of firms and as members of the AIA can better handle the liability situation

Read this Memo carefully Keep it as a resource And be assured that we will be exploring every avenue and tapping every resource to help you meet the challenge in the critical months ahead

Sincerely

R Bruce Patty FAIA

Is It Insurance? [redacted]

AIA What is the cause of the current liability crisis?

HUNTER I view the problem fundamentally as one of the insurance industry's cyclical behavior Insurance companies go through periods of high profit and low profit The periods of high profit tend to drive particularly larger accounts into self-insured and offshore operations Insurers respond by cutting prices to try to stop that and their profitability falls But once the profitability improves as it does dramatically over the few months and years after these bottoms we stop hearing about tort problems

ROSENBERG We think there is some pattern to insurance prices some cyclical nature But the underlying problem is that our nation's system of civil justice is in a process of self-destruction To the extent that the legal environment has become more hostile the cost of insurance has gone up and will continue to reflect that

AIA Is 1986 going to be a bad year for architects?

ROSENBERG In part it depends on whether the losses continue to climb The property casualty insurance industry in 1984 lost $3 8 billion before taxes. In 1985 the preliminary numbers indicated a loss of $2 billion just for the first half of the year It takes about a year for the rate increases to begin to show up on the income side so we're probably looking at a year to a year and a half out before there's stability.

AIA The insurance industry is regulated only at the state level So if local architects wanted to have some effect on insurance and the way it's being sold in their state the only place they could go would be to the state commission?

ROSENBERG That's right. Insurance is regulated state by state and each state has its own regulatory mechanism

AIA What do the commissions at the state level do exactly?

ROSENBERG Protect the consumer from unreasonably high rates and protect the insurance marketplace from unsound insurance practices

HUNTER I think there is mounting evidence that the states are not being responsible in stopping the price gouging that's going on

AIA What guidance would you give an AIA chapter that wants to approach its state commissioner?

HUNTER Well first I would ask the state commissioner to get the statistics from the industry the premiums and losses for each of the last five or 10 years the losses paid as well as incurred the investment income allocable to the reserves of the architect's line Talk to the commissioner about unfair market practices For example most states are now moving in the direction of declaring it an unfair market practice to change policy terms or rates during the course of a policy and to cancel policies unfairly.

ROSENBERG The first thing we would suggest they do is to conduct their own internal audit of risk. A survey of their own members as to how many of them have been sued how frequently, for what amount, what the settlements were

When the American Medical Association did a similar survey they saw that their average settlement had gone from less than $50 000 to more than $300 000 in a five-year period

AIA. Many people say that much of that is due to rising medical costs and legal fees

ROSENBERG In many kinds of professional liability, especially in the architects' and engineers' area, legal fees are a very substantial part of the insurance expense More than half the cases brought against architects are settled without any payment to the plaintiff One of the proposals we've put forward includes giving serious consideration to the British model If you bring a civil lawsuit against a person and they successfully defend themselves, then you're obligated to pay the cost of that defense

AIA Of course there's a down side—people wouldn't settle cases that should be settled They'd play Russian roulette and go to court for fear of having to pay attorneys fees

ROSENBERG If you demand the right to have a protracted legal battle at unlimited expense to defend against a minor claim you're on shaky ground when you turn around and talk about the cost of your insurance policy

AIA But architects would say that when they settle they still get penalized for having settled because their premiums go up based on the cost of the settlement

ROSENBERG Well this is addressed in many cases by a deductible within the policy

HUNTER I think it's wrong to put the defense costs inside the limit of liability If the insurers really hate lawyers so much why do they want to pay them before they pay the victims? If they want to have caps on defense costs there ought to be a separate limit outside the limit of liability

AIA One of the problems architects feel they have is negotiating with only two insurance companies That's not much negotiating room

ROSENBERG We get back to the problem of profitability The fact is that insurers do not believe professional liability is a very profitable line right now

AIA Why can't anyone obtain asbestos abatement insurance?

ROSENBERG Asbestos is a basically uninsurable line because of the legal liabilities

AIA But the people who are trying to do asbestos abatement now would argue that there are specifications on how to do it safely and that people know that it's a dangerous commodity and know how to protect themselves

ROSENBERG It's a risk with a very long tail Claims may not show up for another 20 years

HUNTER This is the typical industry gibberish There are no claims. Insurers are pulling out because of potential claims sometime in the future with no statistics or other justification

ROSENBERG The insurance industry is not going out and issuing cease and desist orders to anyone The people who are seeking insurance agree that there's an element of risk here They are free to go ahead without insurance but they say they won't

HUNTER: Many states require the insurance

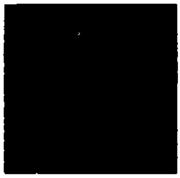
ROSENBERG Well they should take that up with the states

AIA I'd like to give each of you a chance to summarize

ROSENBERG What we're seeing in the insurance marketplace today is primarily a reflection of chaos in the legal system and the crying need for civil justice reform in our country Until we take positive steps to bring under control the legal process and to make that system more rational and predictable insurance is going to continue periodically to create problems

HUNTER I think it's clear that the cycle drives this problem that the insurers take advantage of it to gain excess profits and to try to take away the rights of victims I think the bulk of the problem will be over in 18 months when the cycle is back up and profits are excessive again

Is It the Law?



AIA What is a tort?

MESSINA A tort very simply is a civil wrong It is an act by one member or group in society that causes harm to another member in society It may or may not have criminal implications, but it either causes financial/business reputation [harm] or physical harm

SCHWARTZ It is a wrong (and this would be particularly important for architects) that arises from the law but not from any contractual agreement An architect can be sued because he has breached a contract and that in effect is a civil wrong But tort law imposes an obligation that is separate from anything an architect has agreed to Some people say it's the law of civil wrongs other than breach of contract

AIA What is a frivolous suit?

MESSINA A frivolous suit is one that is not based on any hope of recovery on the merits

AIA Why would a lawyer bring a frivolous suit?

SCHWARTZ Some lawyers bring claims for which there really is no factual or legal basis because they hope to get a settlement from the other side which will not want to pay substantial legal fees to defend the claim

MESSINA I think there are two other things also One is publicity Some lawyers just like to see their names in the paper The other probably the most prevalent reason is simply error in judgment by inexperienced lawyers who do not screen their cases

AIA One of the problems that architects have is that the construction industry is so complex that very often they get sued simply because the lawyer has no understanding of construction and can't figure out who did what

MESSINA That's true but sometimes the avenues of information are closed leaving [a lawyer] no choice but to bring action so [he] can sort out the parties

AIA What are architects to do when they feel absolutely blameless?

SCHWARTZ After consulting counsel the architect should supply information to the plaintiff's attorney for agreement and demonstrate why he is not responsible The plaintiff's lawyer if he sees this is the case may withdraw the suit or seek [the architect's] cooperation in trying to find the responsible party

AIA Is that what architects do?

MESSINA No and that's why they get sued ordinarily

AIA What else makes architects suable?

MESSINA One thing is they don't document We had a case where the architect didn't document something about the shop drawings that would have exonerated him

Another thing is they sometimes assist in the selection of the general contractor and they exercise absolutely no independent judgment as to his qualifications

SCHWARTZ Yes, a better division or responsibilities—a clearer division of responsibilities—in the beginning of the project would be helpful to everybody if and when something went wrong with the project Along with the division of responsibility ought to go an allocation of liability by contract among the parties before an event occurs

AIA Would you sue an uninsured architect?

MESSINA Yes I did It wasn't very profitable I didn't know he was uninsured Would I do it again? It depends If I needed information from him I probably would if he was not being cooperative

AIA What would you advise about going bare?

MESSINA I guess it's an economic decision but you're getting into an area that's kind of on the fringe of my area

AIA Do architects know how to choose lawyers or do they go to one lawyer and expect to find a full service attorney?

MESSINA From my experience they just don't see lawyers at all It looks as if they've had no legal advice

AIA Can't someone who is not part of the contract sue you in tort?

SCHWARTZ That's true You cannot protect yourself from a tort suit by a person who isn't a party to the contract That's what a hold-harmless agreement is for You are held harmless from a lawsuit

For the most part the law in the area of architect liability is still based on fault individualized responsibility—an architect's engaging in behavior that was not reasonable in light of the circumstances in which he operated Some decisions create problems for architects by placing more responsibility for safety on the architect than he may have contracted to take In that situation the only thing to do is decline the job and I know that's very difficult

AIA If we could draft legislation making "state-of-the-art" an absolute defense would you support that legislation?

MESSINA State-of-the-art is not a very difficult defense for lawyers to get around If they say "state of the art" is what everybody was doing then that's easy to beat Real state of the art is what was technologically feasible and possible I could find reasons not to oppose it except I don't like the word "absolute" defense Lawyers like loopholes

SCHWARTZ The standard should be at least what was feasible in the circumstances

AIA What do you think the chances of tort reform are?

SCHWARTZ When you get involved in so-called "tort reform" there is a natural constituency lined up against you "Reform" to an architect is not reform to members of the plaintiff's bar members of the public who may be injured union members and general consumer groups So if you are going to try to bring about a reform a first step is to try to come to agreement with at least one of those groups before you go forward AFL-CIO or a principal consumer group [like] Consumer Union [or] Consumer Federal of America

It is probably very difficult in the large states to come to any agreement with the Trial Bar I think they realize that if the tort law gets too extreme [in favor of] the plaintiff the system may collapse there'll be no insurance and there will be no one to sue But the organized Trial Bar still opposes any effort to make the common law of torts statutory

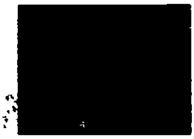
AIA Are you saying that trial lawyers like to take their chances before a judge or jury, and not before a state legislature?

MESSINA I think that responsible lawyers don't want the system to collapse because it is better than what would replace it

If you want statutory reform we found the only way to get it in our state was through compromise We have battled and battled with the business associations and finally when the Trial Bar members and the businessmen sat down we hammered out a tort reform bill Neither one of us loves it but both of us can live with it

SCHWARTZ To get back to architects—they should realize we are not going to take the system back to 1950 It simply cannot be done

Is It Us?



AIA Both DPIC and Victor O Schinnerer (VOSCO) had agreed to meet with us today but we were advised yesterday that DPIC had decided that they could not make the meeting And so we are with VOSCO people only But in this current market they provide coverage for at least half the insured architects.

Is there any good news for architects about insurance?

DUVALL We did a study some time ago that indicated that the losses we paid in dollars represented only six one-hundredths of 1 percent of the construction values put in place by the architects and engineers against whom those claims were made That's an incredibly high performance a very low error rate The problem is in those rare instances—and six one-hundredths of 1 percent means a rare instance—it's very costly

AIA Looking at that small percentage what can architects learn from those claims?

DUVALL If you look at the period 80 to 84 the frequency of claims against architects did not increase all that much It went from 43 per 100 insureds in 1980 to 44 4 in 1984 So it's not the frequency of claims it's the severity of them that is the problem

AIA Of the claims that go to trial do architects win more or lose more?

GENECKI They win two-thirds of all the claims that go to court

DUVALL But I m afraid in most of the cases we settled out of court there really was a basis for a finding of fault against the insured in the minds of our defense lawyers and probably the architects themselves because they had to give their permission to settle the cases

AIA What kinds of people were the claimants?

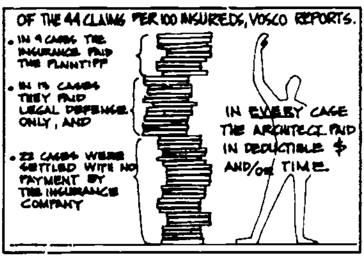
DUVALL The most recent study we did involved 802 claims on architectural projects and in 372 of those the claimant was the owner

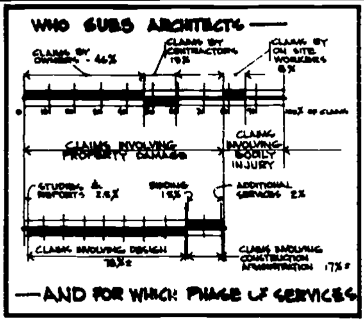
AIA So these were claims that might have been prevented contractually?

DUVALL Not in every case because I suspect some number of these claims by owners were actually third-party actions when the owners had been sued by the contractors The second largest category is bodily injury claims by the public

AIA Is there any way architects can use these data to protect themselves?

DUVALL As a starting point, architects should use the standard AIA documents Also if I were an architect I would be very





careful about the financial integrity of my client I d be very careful about the degree to which he had been involved in previous construction and how that had turned out

AIA What else do the claims data say?

DUVALL I think the claims data would disabuse a lot of architects about what they think the problems are I know in the past there was a feeling that bodily injury and death was a major element The fact of the matter is although 22 percent of the claims involve bodily injury and death only 15 percent of the loss dollars are spent on those claims If we could eliminate that 15 percent we would avoid probably one year's rate increase

AIA Then pain and suffering would not be architects issues?

DUVALL Not major issues no

AIA Is it true that half of the 22 percent of the bodily injury claims involve on-site workers?

GENECKI Yes They re the biggest single group we can identify

AIA So if we could convince state legislatures to include us under the workers compensation umbrella we could put an end to 50 percent of the bodily injury claims

At the same time architects feel that the judicial system is a lottery and that there's no predictable fairness to it all Do the claims data bear out that sentiment?

DUVALL Well we ve paid when we thought we would win we ve won when we thought we would lose But I think, overall we ve probably paid when we should have and won when we should have

PORTERFIELD We don't believe the legal system is out to get design professionals

DUVALL I think it's more a case that buildings are very complicated To me a modern building is very much like a ship, and there are virtually no ships that are perfectly designed and there are virtually no buildings that are perfectly designed Buildings like ships need shakedown cruises There's going to be a list of things that need correction The problem is that years ago owners looked to architects to pay only for the major corrections now they re looking to them to pay for more and more

AIA What's an architect to do then given that mentality?

DUVALL In the short term if I were an architect I would be collecting my insurance premium as a direct reimbursement As a reimbursable expense it would be provided in the contract that the owner is going to pay to the architect a percentage of each billing which will be a line item for insurance And if my insurance costs are $2 20 per $100 of billings and I've billed the client for $10 000 I m going to charge him $220 and show it as an item

Now the argument is that it encourage claims but when you ve reached the point where claims are running at 44-plus per hundred insureds there's not much more claims encouragement you can give That is a frightening frequency of claims

AIA What else could an architect do?

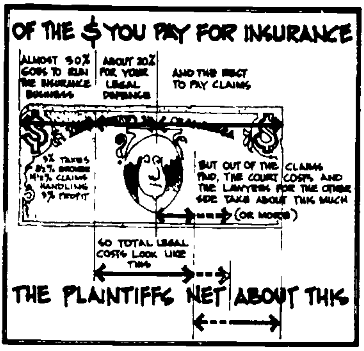
GENECKI He could build into his contract that after some period of operation of the structure the owner will on a fee basis, have the architect come back and make a detailed analysis a walk-through of the structure to see if maybe there are some maintenance items that the owner is not particularly aware of Or the architect finds out that the building is being used a little differently from the way he was told originally and adjustments need to be made

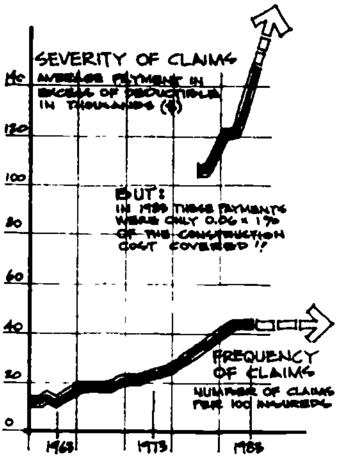
AIA By the same token could you say given the fact that roofs are the primary cause of claims that the architect should go back and watch the supervision of the placement of the roof on the building? On the one hand architects could increase their potential liability because they would be physically on the roof observing the entire installation on the other hand they might decrease liability because finally roofs would be put on correctly Do you have any feelings about that at all—which argument is the stronger of the two?

GENECKI We d rather see them out there

DUVALL The presence of a knowledgeable person has got to create some deterrent to the roofing subcontractor from cutting corners if nothing else

GENECKI Surely if the roof does fail then the courts the





owner and everybody else are going to expect the professional would have been more involved

AIA But they expect it anyway

DUVALL Yes I m not sympathetic to these theories of "let's not do that because by doing it there is more liability"

AIA You d probably say charge more and be present

DUVALL Charge more and do it Be there—with knowledgeable people Just a body there isn't going to do it

Here we re touching on another subject that is near and dear to me and that is I don't think architects charge enough and I don t think architects pay their consultants enough and I think a lot of these things happen because there isn't sufficient talent sufficient staff available competent staff to get done what needs to be done to avoid having these problems I think the fees are remarkably low

GENECKI Sticking with roofing we don t have the empirical evidence yet but it's my guess that 50 percent of all of the claims involving roofing also involved the substitution of material or a system different from that in the original drawings and specs

AIA That gets us back to the 78 percent of the cases that are property damage You say 46 percent of those are initiated by the owner Is it possible that those claims could be deleeted so to speak by having better owner architect relations or having better owner architect contracts?

GENECKI Yes especially if you include relations

DUVALL It used to be that nobody wanted to talk to the owner about the possibility that disputes could arise At 44 claims per 100 insured we re well past it If at the outset of a project an architect has frankly discussed with the owner the problem and the need for some form of contingency fund I think it can be controlled much better than it is being now

AIA Are there any kinds of owners who need special handling special education?

DUVALL Well you have the committee owners And that generally involves churches hospitals and schools

GENECKI And local government

DUVALL Churches have always bothered me because they represent a disproportionate amount of loss and they have all the elements that have got to lead to problems They have a limited budget they always want far more than they can afford it's a committee of amateurs Probably most serious of all they have a

Continued on page six

What Can I

Continued from page five

very vocal constituency, their friends and neighbors, who get very upset if there's the least problem. It makes for a very unhealthy situation from a claims point of view.

AIA: If architects want to work with committees, what do they do?

DUVALL: Well, there's a local architect who has worked very successfully for at least 26 years with churches. He's developed a format for dealing with them, where he tells them at the beginning he's probably going to make some mistakes [and] there are probably going to be extra costs that they don't envisage at this point. He requires them to agree in writing that there will be a fund to take care of those items. Only if the mistakes are of great magnitude will there be any claims. And he's worked very successfully with churches of all denominations.

GENECKI: Firms that have as a major part of their practice or a specialty, if you will, hospitals or churches, do not experience the frequency and severity of problems that firms that occasionally take on these kinds of projects do. They develop things in their rapport and in their relationship with these kinds of owners. Therefore, if a problem arises the committee is more likely to first call the architect.

AIA: Instead of the lawyer. Are there other clients that cause particular problems?

PORTERFIELD: The unsophisticated client. I think the architect needs to recognize that client. Maybe this is the first time they've been involved in a project of this nature. Architects need to educate them, communicate with them as to what to expect and what services are going to be rendered.

Another red flag for an architect would be the client who wants to keep services to the bare minimum, who wants no responsibility for construction phase services, who dictates to the architect exactly what services he wants, what design he wants. We've seen examples where the architect has gone against his better judgment, thinking he's giving the client exactly what he wants, yet without taking the necessary precautions to advise a client that this design may not work.

DUVALL: You asked if there are any other statistics that might be of interest. Yes, and they deal with severity. In 1980 we were paying $122 000 for each case that was closed with a payment to the claimant. In 1983, that number had gone up to $148 500.

GENECKI: Remember also that at the same time, deductibles are moving up. So the total cost is more dramatic than the numbers just given.

AIA: Could one say that architects should view themselves as the first insurance company, with the insurance company being the reinsurer?

DUVALL: Yes. They are very definitely paying the first layer of loss, no question about it. And that first layer is getting larger, on average, every year.

AIA: Is it true that close to 90 percent of the claims are filed within six years of substantial completion of the building?

DUVALL: Yes. About 46 percent are filed within one year. That includes claims that are brought while the work is still in progress. And my guess is that the majority of our most severe claims have arisen during construction.

AIA: They're the ones that should be in the most immediate control of the architect.

DUVALL: They're the ones that involve large costs.

In searching for new and better ways to cope with the problems of professional liability, we have talked with insurers, lawyers, accountants, management consultants, architects and other design professionals.

The following is a collection of what we believe are the best tips we've heard to date. In addition to those who participated in the interviews above, top contributors include Frank Stasiowski, president of Professional Services Management Ltd.; Barry Le Patner, attorney with the law firm Le Patner, Gainen & Block; Fred A. Stitt, architect and editor of the Guidelines Letter; Vernie G. Lindstrom Jr., president of AGC; Weld Coxe of the Coxe Group; Thomas F. Sheehan, president of the insurance company Thomas F. Sheehan Inc., and Howard Birnberg of Birnberg & Associates.

Some of the ideas involve practice management, some involve contract documents, some involve chapter activities, but each should be evaluated in the same way.

Shape your own firm's liability agenda. Ask yourself: Do we charge enough? Are our client-relations skills what they ought to be? Are our contracts the ones we want to sign? Do we have a system for quality assurance including project memos, forms, checklists and field report forms? Is a principal of the firm specifically assigned to quality control? The first step might be a staff meeting to evaluate the relevance of these tips for you.

Protect yourselves from suits. Use the standard AIA documents. Be very careful about the financial integrity of your clients. Investigate the degree to which clients have been involved in previous projects and suits.

The best offense is a good defense. Use AIA Document B161 for pricing and scope definition, the B141 owner-architect agreement and the A201 general conditions, along with clear, precise documentation of every project decision. These are the essentials of your defense in court.

Quote to your clients paragraph 5.1.6 of Article 5 of your B141 contract as the basis for passing on to them the increase in your liability insurance premium.

Don't begin work on a project until a contract has been negotiated, written up, reviewed by your lawyer and you, and signed. In addition, make sure everyone working on the job reads and understands the contract and what duties your firm has promised to perform.

Claims data suggest that architects who do not perform construction administration are vulnerable to liability as a consequence of owners' and contractors' misinterpretation of documents. Insist that construction phase services be included in every contract so that communications remain between you, the client and the contractors.

Use Paragraph 1.7.9 of AIA Document B141 to justify building into your contract, at an additional fee, a postoccupancy project evaluation to advise the owner about whether or not the building is being used correctly and maintained as necessary and to determine what design adjustments, if any, need to be made. If possible, incorporate paragraphs 8.5.1 through 8.5.4 of AIA document B162 to define the scope of those postoccupancy services.

If you are asked to take on responsibilities that are not specifically spelled out in your contract, evaluate your new potential liabilities and then negotiate a change order to your contract.

Do?

Undocumented verbal authoriza tions and agreements have little credibility in court Make sure that the specific responsibilities and delivery timetables of both you and your client are spelled out in writing Include agreed upon due dates and level of quality for every item agreed upon

Never make payment of your fee a ' tion of subjective clauses such s upon completion of Spec ' ally spell out what will constitute completion and acceptance

If you cannot or do not wish to negotiate a hold harmless clause with your client on asbestos abatement consider the following Explic , state in your contract that you are not an expert that you have not been trained in the special requirements of asbestos abatement (if you have not) that you cannot be expected to recognize the many forms of asbestos and that if asbestos is found on the site and recognized as such all work will cease without penalty to you so that the client can take the appropriate steps for its removal

Establish better owner architect relations Discuss frankly with the owner the possibility that disputes may arise and the need for some sort of contingency funds to cover such disputes One possibility is to negotiate a consent not to sue" for cost overruns or change orders that total less than some reasonable percentage of construction costs One member wh e firm does only large proj ec uses 2 percent

Beware of clients who want to keep services to the bare minimum who won t contract for construction phase services who dictate to the architect exactly and absolutely what services and design they want

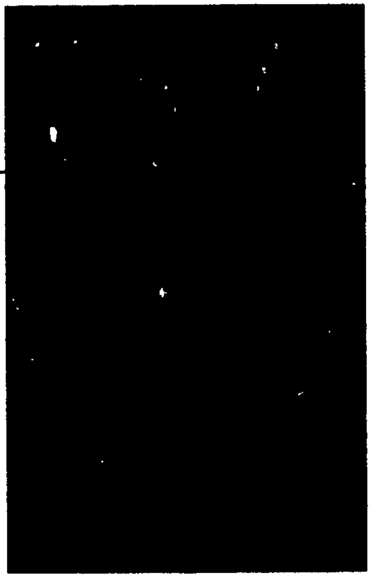
Recognize the unsophisticated clients and build into your fee the cost for their education and for the xtraordinary commitment you ll have to make to foster that education

Roofs and HVAC systems cause more lawsuits than any other items Some experts advise increasing your skills responsibilities and compensation to deal properly with these problem causers Others say use reasonable standards of care but avoid exposure by limiting services and contractual liability In any case don t ignore these potential problem areas Incorporate your specific procedures for dealing with them into a quality assurance program for your practice

Take the necessary time to assure that all mechanical electrical plumbing and structural drawings are coordinated and dimensionally consistent with the architectural drawings Seventy-eight percent of all property damage suits allege mistakes in design and contract documents Lack of coordination between the disciplines has been identified as a major cause for these alleged mistakes

Have the senior partners in your firm take an active and early role in dispute resolution

The insurance industry is regulated only at the state level If you want to affect the way insurance is sold in your state go to your state insurance commission It is the commissioners who are mandated to protect policyholders from unreasonably high rates Talk to your state commissioner about unfair market practices Encourage your state to join the many others that are now moving in the direction of declaring it an unfair market practice to change policy terms or rates during the course of a policy or to cancel policies unfairly



A first step toward tort reform is building coalitions with similarly affected organizations through your state and local components Have your component meet with your local NSPE ACEC AGC and ASLA counterparts When feasible agree on unified lobbying efforts and complementary messages to members and the public Try to get a union or consumer group on your side

Enlist your components assistance in convincing your state legislature to include architects under the workers compensation umbrella to enact reasonable statutes of limitations to enact rules of procedure that assist courts in controlling bad lawyering and to modify laws on joint and several liability

Invite your lawyer or an architectural management consultant to conduct a quality control audit of your firm

Attend professional seminars The AIA has been in contact with organizations that routinely sponsor seminars and has included seminar dates in the calendar on Page 8 (DPIC hasn t yet planned any for 1986)

In early spring Victor O Schinnerer & Company will be sending to all AIA chapters free of charge liability videotapes prepared with the National Society of Professional Engineers You may not hear the word "architect " but the issues and the tips are on target Hold a chapter meeting to discuss the tapes your firm may want to arrange a similar seminar

Read up Two of the good books on A/E liability are *Untangling the Web of Professional Liability* by the Design Professional Insurance Company and *Avoid Liability in Architecture Design and Construction* by Robert F Cushman (Wiley & Sons) Victor O Schinnerer's periodical Guidelines for Improving Practice is also helpful

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What Are the AIA's Plans for 1986?

We have told you what you can do Now let us tell you what we will do We have one goal to provide you with the tools necessary to help you regain control over your financial legal and practice requirements Our objectives, however, are many

Practice

- Expand the Professional Liability Network to include component state liability committee chairpersons, state lobbyists and state component counsels.
- Expand the Professional Liability Network by inviting all AIA members to become corresponding members of the Practice Committee
- Disseminate to interested components a liability workshop program with detailed instructions and content for a three-hour do-it-yourself compensation and risk-management brainstorming session
- Publish for architects' clients a booklet on what to expect from their architects.
- Publish for architects a booklet on how best to communicate with clients
- Work with others to develop alternative dispute mechanisms such as mediation and conciliation panels
- Focus on enhancing the AIA documents and architects understanding and use of them through a series of eight workshops
- Hold professional development seminars on liability

Insurance

- Work with the Interprofessional Council on Environmental Design to develop unified risk insurance policies for insurance industry consideration
- Explore the feasibility of creating an AIA captive insurance company
- Work with all insurance carriers to maintain for the AIA a working understanding of the industry and its impact on the profession
- Monitor the commended insurance program and relay findings to the members
- Hold a liability teleconference on January 27 1986 addressing insurance—how to practice with it and without it

The Law

- Continue support of cases on appeal as amicus curiae so that legal issues of nationwide importance to the profession are addressed by informed courts
- Cosponsor the 25th annual AIA/NSPE/Schinnerer & Company Invited Attorneys Meeting
- Explore the feasibility of creating an AIA "attorney network" to assist members in locating attorneys who can meet their needs

Legislation

- Develop a guide for Grassroots on state tort relief legislation as part of the AIA's liability law clearinghouse
- Work with the Interprofessional Counsel on Environmental Design AGC the American Bar Association the Chamber of Commerce and other organizations to affect tort reform
- Continue to work for legislative relief in the area of asbestos abatement

Liability Calendar

January
AIA Grassroots
Jan 29–Feb 1
AIA/NSPE/Schinnerer & Company Design Professional Liability Course
Jan 22 Dallas
Jan 24 Honolulu

February
AIA Professional Development Liability Prevention and Protection Workshop
Feb 20 Philadelphia
Feb 2* New York City
Feb 27 Boston
Feb 28 Detroit
AIA/NSPE/Schinnerer & Company Design Professional Liability Course
Feb 21 Tampa, Fla

March
AIA Professional Development Liability Prevention and Protection Workshop
March 20 Tampa Fla
March 21 Nashville
AIA/NSPE/Schinnerer & Company Design Professional Liability Course
March 4 Albuquerque N M
March 6 San Francisco
March 20 Columbus Ohio
PSMJ Going Bare and How to Do It
March 4 Boston
March 7 Chicago
March 11 Los Angeles
March 14 Dallas
March 19 Orlando Fla

April
AIA Professional Development Liability Prevention and Protection Workshop
April 4 Minneapolis
April 17 Tulsa Okla
April 18 Dallas
AIA/NSPE/Schinnerer & Company Design Professional Liability Course
April 10 New Jersey
April 24 Detroit

May
AIA Professional Development Liability Prevention and Protection Workshop
May 1 Austin Tex
May 2 Houston
May 15 Denver
May 16 Seattle
May 29 Los Angeles
May 30 San Francisco
AIA/NSPE/Schinnerer & Company Design Professional Liability Course
May 13 Boston
AIA/NSPE/Schinnerer & Company Invited Attorneys Meeting
May 21–23 San Francisco

June
AIA Professional Development Liability Prevention and Protection Workshop
June 7 San Antonio
June 12 San Antonio
AIA Convention
June 8–11 San Antonio

Memo

Special Issue of the Newsletter of The American Institute of Architects September 1985

Liability:
An Open Letter to AIA Members From Bruce Patty

Dear Colleague

No single issue demonstrates how much architects share a common destiny with our fellow professionals, indeed with our society, as the issue of liability. Hardly a day goes by without a news story about the skyrocketing costs of premiums, protracted legal battles, and record judgments against not only individuals but companies, institutions and even government. Whether we are big fish or small fry, none of us is immune to the mounting costs of providing the services our society needs.

This special edition of the Memo is to bring you up-to-date on liability issues. I want to share with you information that will aid your understanding and point the way toward actions to lessen the burden you and I, as well as our clients, are working under. Our intention is to provide you with a liability handbook, a document useful not only to you, but also your lawyer and your insurance broker.

One of our greatest resources is the problem-solving ability of our members. Since many of you have been in contact with the Institute over the past few months with creative and highly individual approaches to the liability problem, we are rapidly developing a unique resource of helpful tips and ideas that work. With this issue of the Memo, we begin the process of making this resource available to all AIA members. Subsequent Memos will continue the process of transferring this valuable information from those of you who have contributed ideas into the hands of your fellow members.

To get to the heart of the matter, we interviewed J. Sprigg Duvall, president of Victor O. Schinnerer & Company, the firm that administers the AIA's commended insurance program. We asked him the questions you have been asking the Institute's staff and questions you've asked me on my travels around the country. We pulled no punches, and the answers we received were equally direct and candid.

The picture that emerges offers no quick, painless solutions. On the other hand, I am mindful that, not only by your calls and letters, but also by a 1985 convention resolution, you have directed me and the Institute to take any and every action within our power to help you. How has the Institute responded? Let me bring you up to date.

- A major practice management conference will be held in New York City on October 10 and 11. Participants will have the opportunity for face to face discussions with insurers on specific coverage and costs of liability insurance, and will be able to study the overall issue in depth.
- The AIA's commended insurance program will offer further educational opportunities through a series of seminars on risk prevention.
- As reported in the August 8 issue of Engineering News Record, we are working with the Interprofessional Council on Environmental Design (ICED) to explore the feasibility of unified risk insurance, whereby all members of a project team are covered by a single policy.
- Recognizing that insurance companies and the tort systems are regulated not at the federal but at the state level, we are preparing a major program on state legislative initiatives concerning liability for the next Grassroots. Participants in this program will receive specific advice on dealing with the problem where they practice.
- In addition, the Institute is filing amicus curiae briefs on behalf of members confronting professional liability court cases at the appellate level.
- The Institute is investigating the possibility of the federal and state governments acting as reinsurers for primary insurance.
- The Institute is also investigating the feasibility and value of starting a captive insurance company for our members.
- The Winter issue of Architectural Technology will contain the results of a biennial survey of the insurance industry so you can easily compare the cost and coverage offered by different companies.
- Coalitions have been and are being built with others similarly affected by the liability problem, such as the American Consulting Engineers Council, the National Society of Professional Engineers and the Associated General Contractors.

As I noted earlier, no one of these actions leads to the solution we're looking for. However, together they demonstrate determination on the part of the Institute and its members to gain control of our destiny. In the months ahead, we will be gathering ideas and strategies from those of you who are participating in our Professional Liability Network. Within the Institute, all departments are focusing their resources on the liability question. Where creative, effective action can be taken, I can assure you it will be.

Although the present liability crisis is severe, it is by no means unprecedented. As business writers in Forbes, the Washington Post and the New York Times have noted, the business cycles of the insurance industry resemble nothing so much as a roller coaster. We are unwilling passengers this time around, but the Institute will try to help you make it through in one piece while we work with other professionals, our clients, government and the insurance industry itself to try to make sure we do not get on this ride again.

Sincerely,

R. Bruce Patty, FAIA
President

Liability: What You Can Do

The appearance in the July 31 Memo of an idea from Christopher J Smith, regional director from Hawaii, to include newly insured insurance costs as a line item on a client's bill triggered an outpouring of creative ideas from our members.

Here are some of those ideas, gathered by the AIA Architects Liability Committee. Not all of these ideas will work for you. Their utility depends on your firm's size, type and practice, as well as the particular laws of your state. For example, Smith's tactic may be viewed by some clients in some states as an invitation to sue. In short, none of the ideas that follow are officially sanctioned as AIA policy. They are simply potentially helpful suggestions. All require informed business decisions by you, with advice from your own counsel.

Shop widely for insurance. Indeed says Roy C Vince, himself a broker with Professional Liability Brokers & Consultants Inc. of Des Plaines, Ill., you should not necessarily rely on one broker to do your "shopping" for you. Some insurance companies license brokers exclusively, so if your broker is not a licensee of that company, he or she cannot sell that company's policy.

Shop early for insurance. Begin your search at least three or four months before your policy runs out. Given the drop-out rate of insurance companies in this tight market, those few companies still selling architects liability insurance are being inundated with applications.

And lastly, if you are offered **renewal insurance** with acceptable terms at an acceptable price, take it. Changing carriers can mean lower premiums but sometimes with the risk of lost coverage for services previously covered.

For more information on different insurance companies' deductibles, premiums, coverage and other details, the Association Administrators and Consultants Inc. encourages you to write for a free copy of **the results from their recent survey of the insurance industry.** Contact AAC, P O Box 19570, Irvine, Calif 92713, (800) 854-0491 In California, Alaska and Hawaii, call (714) 833-0873

If you must reduce premiums, Paul M. Lurie of the Chicago law firm Lurie Sklar & Simon Ltd. suggests that one method is to increase deductibles. He adds that large deductibles can be made manageable by **setting up a line of credit at your bank** in the amount of the deductible. Loans could be made under this line of credit as needed, but you would be able to pay for the loan over a period of time, rather than in one lump sum.

Lurie also raises the possibility, with asbestos-related work, of **establishing a separate, nonprofessional corporation** to handle the asbestos-related activities of a project and having the architecture firm itself handle only the professional architectural work. In this way, members of the architecture firm would be insulated from personal exposure associated with the inability of the corporation to pay claims. Have your lawyer explore the arrangement, Lurie warns, as not all state laws permit it.

The AIA Liability Committee suggests that you may want to retain another architect—whom you respect—and ask him or her to **red-line your contract documents** before you issue them for construction.

And **use standard documents.** Indeed, it makes no difference whether your firm is large or small. The contract is your first line of defense, reminds Philip Purcell, Esq., of Chicago's Kirkland & Ellis. Do not dilute it with uninsurable undertakings, indemnities and escalated standards of care.

In fact, says Alan E Harris, Esq., of Farella, Braun & Martel in San Francisco, you may want to draft **the "general conditions"** to include a requirement that the general contractor **name the architect as an additional insured** on the comprehensive general liability policies. This arrangement may provide coverage in addition to that afforded by your errors and omissions policy. Furthermore you may want to ask all your consultants and contractors to certify they have insurance. At any rate, do not agree to limitations of liability with your consultants unless you have similar limitations of liability with your client.

From Washington, DC Antonio C Ramos, AIA, and his attorney Arthur T Kornblut, who is also chairman of the American Bar Association Forum Committee on the Construction Industry and an architect himself, comes the language for a **hold-harmless clause** involving asbestos abatement—the most-often-requested text:

> The Architect hereby states, and the Owner acknowledges, that the Architect has no professional liability (errors and omissions) or other insurance and is unable to reasonably obtain such insurance, for claims arising out of the performance of or failure to perform professional services, including but not limited to the preparation of reports, designs, drawings and specifications, related to the investigation, detection, abatement, replacement or removal of products, materials or processes containing asbestos. Accordingly, the Owner hereby agrees to bring no claim for negligence, breach of contract, indemnity or otherwise against the Architect, his principals, employees, agents and consultants if such claim in any way would involve the Architect's services for the investigation of or remedial work related to asbestos in the Project.
>
> The Owner further agrees to defend, indemnify and hold the Architect and his principals, employees, agents and consultants harmless from any such asbestos-related claims that may be brought by third parties as a result of the services provided by the Architect pursuant to this Agreement.

In every way possible **get the owner involved.** According to Vernon Reed, a member of the AIA Architects Liability Committee, the better the owner understands your design, its rationale and its intentions, the more likely you can avoid misunderstandings and misapplications. To that end you may want to offer a new service. Provide in your contract for an additional (billed) service to the owner for a joint post construction inspection of the building(s) six months after completion. At that point you can both check for faults or misuse and correct them before they mushroom into serious problems.

Continue your own **professional education** through such activities as the AIA's October Practice Management Conference in New York City and the regional loss prevention courses conducted by Schinnerer & Company for the AIA. Increasingly, other insurance carriers and several architecture schools are also offering courses on risk management. Design Professionals Insurance Company offers courses all around the country. As AIA's commended program, Schinnerer will fashion a course specifically for your component on request. Remember the better you practice, the less chance you will ever need to dip into your deductible.

We welcome your feedback on the ideas presented above. If you have any other suggestions, jot them down and send them to Ava Abramowitz, associate general counsel at the AIA.

Liability: Questions and Answers

The Institute receives more than 50 calls a day from persons with questions about liability The AIA interviewed J Sprigg Duvall president of Victor O Schinnerer & Company and asked him to respond to the questions you most often ask us. Schinnerer & Company is the program administrator for the AIA-commended program underwritten by CNA Insurance Companies Duvall has been associated with the AIA commended program since its inception 28 years ago

Q: Why are my insurance premiums increasing at such a dramatic rate?

A: Increasing rates are a reflection that inadequate rates in the past are now being adjusted over a very short period of time From the late 70s until the mid 80s, the insurance industry was on what I consider to be a reckless binge of rate cutting in all classes of professional liability Rates were ~d back or even cut despite the fa that loss severity and loss frequen y continued to increase

Now we are seeing a rapid catch-up in the case of architects and engineers whose own loss experience has been deteriorating at a rate about equal to the increase in the construction cost index

The rate increase in the CNA program has ranged between 5 percent and 30 percent for most architects Some very large firms and firms with poor loss records have seen larger increases

Q: But many architects are reporting rate increases of 200 percent to 300 percent

A: First of all you have to distinguish between rate and premium For example if a firm s volume of work doubles and its premium doubles .nere is no rate increase Many firms have seen their premiums increase far in excess of the stated rate increase because of dramatic increases in their billings

Secondly some of the firms that are reporting three- or fourfold increases in rates were insured last year with insurance carriers whose rate structure bore no realistic relationship to claims actually made against architects Today these insurers are no longer in business or in some cases have raised their rates to levels higher than the commended program s

Q: What is the claims track record for architects?

A: Frankly pretty bad The frequency of claims reported by architects in 1978 was about 35 claims for every 100 firms. In 1984 it was about 44 claims for every 100 insured firms. And the average cost of a clair closed with a payment by the insurance company almost doubled between 1977 and 1983 In 1983, CNA s average cost of a paid loss was more than $160 000

Q: Aren't frivolous suits a big part of the problem?

A: I would have to answer No Just because a claimant fails to collect from the defendant does not mean that the suit is "frivolous There are suits that should never have been brought against an architect but unfortunately our legal system does not yet provide an effective way to penalize the lawyer who brings such a suit.

Beyond that, we do still offer a sp~al type of coverage called "first dollar defense cost to pay all legal fees for the small to medium-sized firm that s involved in any suit whether it be frivolous or not

Q: Penny for penny where do our premium dollars go?

A: In the commended program 69 5 cents of each premium dollar is allocated to pay losses (of that amount more than one-third goes to pay defense attorney s fees, nearly two-thirds pays plaintiffs awards) 3 cents is needed to pay premium taxes; 10 cents goes to the insured s broker and 14 5 cents is for claims handling underwriting and loss prevention activities The remaining 3 cents is CNA s expected underwriting profit However in each of the past seven years the claims costs have been much greater than 69 5 percent, resulting in no underwriting profit and substantial underwriting losses.

Q: How do the losses caused by engineers and those caused by architects compare?

A: The losses of engineers as a group are very similar to the losses of architects as a group We keep the loss statistics separately for architects and each of the engineering disciplines The rates are based on the actual loss experience of each

Q: If I've never had a claim why do my premiums keep going up and why do I have to pay as much as architects with bad loss records?

A: The whole basis of insurance is that all insured members of a particular group share the burden collectively so that when the loss experience is deteriorating for the group everyone pays part of the increased cost Architects with good loss records do not pay anywhere near the premium amount that comparably sized firms with poor loss records pay A firm with good loss experience may have its premium discounted by as much as 25 percent On the other hand a fir.. with bad loss experience could be paying as much as 100 percent more in premiums.

Q: Given what is happening now how much should I budget for professional liability insurance in 1986?

A: As noted at the annual program meeting in April rates in the commended program will increase by an average of 39 percent on Oct 1 1985 The increase will vary dramatically from state to state and from firm to firm The rate increase will average less than the 39 percent for firms with billings of $1 million or less and will be higher for larger firms.

The best general advice I can give an architect insured under the commended program and working on a 1986 budget is to multiply his or her current premium by a factor of 1.39 to reflect the average rate increase plus an additional factor to reflect any change in work volume Should an architect insured under the commended program need a more precise indication I encourage that person to contact Schinnerer & Company

Q: Why are you going to exclude coverage for asbestos-related claims?

A: There really is no choice at all In the first place, it will no longer be possible to obtain reinsurance for claims involving asbestos This is a worldwide reaction by the insurance industry to billions of dollars of loss for claims already made If asbestos were not excluded architects might very well end up being the only ones in the construction process who still had coverage for acts involving the use of asbestos

The real problem for architects as a result of their specifying asbestos in the past is one of adequately presenting to the courts a "state-of-the-art" defense The architect s exposure on past practice is really a question of defense cost for which we hope to find a solution in the near future

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In terms of the abatement of asbestos, we feel the only solution is through legislative action, preferably at the national level, and we are prepared to assist in every way we can. This is a complex issue and one we plan to cover in more detail in our Guidelines for Improving Practice series.

Q: But isn't it unfair to exclude asbestos coverage when I've already paid the premium?

A: Whether or not it's fair is a moot point. Unfortunately, insurers and reinsurers have suffered substantial and unanticipated losses for asbestos claims in past years, and they are not prepared to continue to expose themselves to new claims in this area.

You have to remember that a claims-made policy is intended to provide coverage for claims made during the policy period for work done prior to the policy period or during the policy period. The AIA-commended program began in February 1957 and it was always intended to insure architects for their customary and usual professional services. This is the first time in the history of the program that coverage has been excluded for any normal part of an architect's practice without at the same time allowing a buy-back of that exclusion for an additional premium. The magnitude of the asbestos problem is such that that option is simply not available at this time.

Q: Why shouldn't I go bare?

A: Any architect who goes bare obviously faces the risk of going bankrupt. In addition, remember that in most states an architect is still personally liable for his or her negligence even if the firm is incorporated. The corporate shield does not protect an architect from claims alleging professional negligence.

Q: Wouldn't architects be better off getting coverage in an architect-owned captive?

A: In the short term, a captive is not going to change the situation. The captive would have to buy reinsurance and the current unfavorable climate within the insurance industry is a result of very large underwriting losses experienced by reinsurers. Also, reinsurers tend to look less favorably on a captive than on a commercial insurance company that is obviously trying to produce an underwriting profit for stockholders. In the long run the captive is, at best, going to save the insureds s[illegible] fraction of the expense [illegible], or expense loadings that go into the rate-making process. A captive is still going to have to charge enough money to pay the losses its insureds incur.

Q: Why should the AIA have a commended program?

A: I think the AIA should have a commended program because its commendation has been the most important single factor in maintaining the availability of insurance for architects over the past 28 years. Commendation indicates a commitment on the AIA's part to active participation in coping with the professional liability issue. It creates a partnership between the professional society and underwriters toward a common goal.

Commendation has also provided an incentive for Schinnerer & Company to provide a number of services to AIA members that would not otherwise have been available to them.

Q: OK, then why you?

A: I think the AIA should continue to commend the Schinnerer/CNA program because the program itself has demonstrated long-term stability that has not been obtainable from any other insurance company over the life of the program. I don't know the exact count now but over the years some 15 other carriers that offered coverage to architects no longer write the class of insurance. At least three more totally dropped off the market in the past year. Today the Schinnerer/CNA program is the only one available to architecture firms of all sizes anywhere in the United States.

Of course, another reason to continue to commend the program is that it does in fact meet all the criteria established by the AIA Board a number of years ago and continues to meet those criteria.

Furthermore, ever since 1957, Schinnerer & Company has offered valuable services. I'll mention a few. We have made our staff available to the AIA's Contract Documents Committee. We work closely with the Architects Liability Committee and keep it advised on premium and loss data in the insurance program. We provide assistance to many states in their lobbying efforts with their state legislatures, and we have testified on behalf of the AIA a number of times in Congress. We have spent many hours participating in negotiations with state governmental authorities concerning contract documents for architectural services. We stand ready at all times to provide any assistance needed in the liability area to AIA members, components or staff.

Q: Realistically what do you think the AIA can do?

A: For the very near term, practically nothing that would be of any real help for your members. Looking down the road, I would love to see the AIA work with other professions in a concerted effort to bring about reforms in our tort system that are desperately needed to stop the escalation of loss amounts.

I think another key issue is the manner in which architects recover their insurance costs from their clients. We have recommended for a number of years that professional liability insurance and, preferably all of the architect's insurance costs be a reimbursable item. Otherwise, there is no way for the architect to come near recovering insurance costs as they occur. I can assure you that the contractors and the suppliers have very carefully built their insurance costs into their prices and in fact, have probably added an overhead factor to those costs. Architects must understand that they have not just an insurance problem, but a liability problem. Recognition of this fact will be the first step toward long-term management of the problem.

Liability Insurance: Who Wants Your Business?

BY KAREN HAAS SMITH

In August, nine professional liability insurance firms responded to the AIA's biannual insurance survey this article is based on those responses But by mid-October, many of the companies asked to revise their statements—that much changed in just two months

More change should be expected, and not for the better At presstime, three of the companies surveyed were not taking new business Others were not offering the higher limits of coverage The bottom line is If you have and can keep adequate coverage at a price you can afford, consider yourself fortunate.

"I'VE TOLD CLIENTS WHOSE PROFESSIONAL LIABILITY INSURANCE premiums have doubled this year that they were lucky," reports Chris Noble, who is in the thick of the current insurance crises by virtue of his position as an attorney with the Boston firm of Hill & Barlow, counsel to many major architectural firms "Very few of our clients have not seen doubling of their liability premiums, and some premiums have more than tripled."

Paul L. Genecki, vice president of Victor O Schinnerer and Company, sees no improvement soon "I don't anticipate the insurance industry as a whole righting itself until 1987, and that means architects should expect further increases, especially if their policies were last renewed in the first half of 1985," he says

What's worse than sky-high premiums? Not being able to obtain coverage at all.

Higher limits of liability coverage, often required by clients, are becoming unavailable, at least at reasonable prices Some activities—asbestos abatement for example—can't be covered for any amount.

It's small comfort to architects who suddenly find vital liability insurance protection priced out of their grasp, or simply unavailable, that the reasons behind skyrocketing premiums have very little to do with the design business Or that engineers and doctors and accountants face similar problems No it doesn't help that the problem is due in part to factors seemingly out of everyone's control.

The current situation is a severe constriction of the always cyclical casualty insurance market. Some don't hesitate to blame insurance company management, wondering why rates weren't being adjusted years ago One lawyer said insurers are penalizing current insureds for the insurer's past business mistakes

Step into the shoes of a reputable, stable American underwriter however, and it's easy to understand that insurers are in many ways at the mercy of international and domestic market conditions

"Three years ago, there were 16 markets [that's insurance talk for insurance companies] in the design professional liability field. Now there are nine. All those companies swamped the market by writing at cheap prices and lost their shirts," explains M Linda Deiss, assistant vice president at Illinois R.B Jones a Chicago-based underwriter "Now the reinsurers want higher rates " (Reinsurers provide coverage for higher limits of liability In effect, they are investors who insure the insurer)

When interest rates were high, the insurance companies relied on investment income rather than underwriting profits to keep premiums low. Design firms were courted and wooed from one corner to the next with promises of lower premiums and expanded coverage Meanwhile, underwriting profits suffered as the American legal system encouraged more claims and more severe claims losses. Still high interest rates kept the insurers solvent if not profitable

How much have your company's rates increased in the past 12 months on an average?

	Last 12 months	Next 12 months
Schinnerer	35%	<39%
DPIC	40–100%	20–25%
Shand, Morahan	>100%	?
PMI	50–100%	?
Illinois R B Jones	40%	?
INAPRO	125%	?
Sheehan	25–50%	?
PLU	50–100%	?
IMI	50%	?

Karen Haas Smith, former acting editor of ARCHITECTURAL TECHNOLOGY *is now president of Editors Ink of Washington an editorial consultation firm*

Until last year 1984 produced the worst financial results for the insurance industry since 1906, the year of the San Francisco earthquake. In all, the industry registered a bottom line loss near $3.5 billion. Declining interest rates, continuing heavy claims losses and the relative strength of the American dollar wrought a crises in the undercapitalized reinsurance market, hitting the stable old primary insurers and wiping out some new, price-competitive ones.

The American casualty insurance market—which includes professional liability insurance for a variety of service professions—was particularly hard-hit by the constriction of the London reinsurance market. This year, when the time came to renew their treaties (insurance talk for the legal agreements with reinsurers), the American primary insurers found the reinsurers charging much higher rates or pulling out of the market altogether. The reasons were several. With the dollar high, the capacity of the London market is severely diminished. The losses reinsurers are suffering from their existing books of business are so large they are no longer covered by investment income. Further, one industry insider says, "the London reinsurers are generally put off by the American legal system."

Where once they were courted, design firms are now rejected. One insurer reportedly dropped its 30 largest design firm clients because it could not obtain sufficient reinsurance. Illinois R B Jones, Shand, Morahan; and PMI have, at least temporarily, stopped accepting new applications from architects. The others have become much more selective. Nobody wants high-risk clients—and risky business includes government, school and medical work, condominiums (they are speculative, often poorly constructed and offer many potential claimants), sports and convention centers, and "projects within 1,000 yards of navigable waterways." No one will insure asbestos-abatement and hazardous waste projects.

Everyone's base rates have gone up.

WHAT WILL HAPPEN NOW?

"Reinsurance capacity may indeed shrink further," one experienced underwriter said, "but a lot is predicated on how underwriters do this year—if we can show a profit and convince reinsurers to stay around or enter the market. The London market may not come back—they have sustained too many losses already from their existing book of business but there are numerous reinsurers in Europe, Japan and elsewhere. Since rates are high, it would be a good time to enter the reinsurance market, without an existing book."

The responses to the AIA 1985 Professional Liability Insurance Survey will be used in a seller's market. This year, the question for design professionals is not "With whom do I want to do business?" but "Who wants my business?" More than ever, the help of professional liability specialists—including a well-informed, knowledgeable insurance broker and a good attorney—is indispensable. If you have adequate coverage and your insurer offers to renew at a price you can afford—especially if it's within the ranges on the chart below—for heaven's sake, renew it. And engage in active risk control.

JUST HOW MUCH HAVE PREMIUMS INCREASED?

The responses listed in the chart on page 36 confirm dramatic increases in *average base premium rates*. Actual premiums have, in many cases, increased more than average because of specific underwriting conditions. Size of billings, prior claims, location of the firm and its projects, and the nature of the practice and projects are some of the major factors affecting premium determination.

Schinnerer shows a relatively low average-base-rate increase of 35 percent this year; it forecasts similar increases next year. DPIC anticipates a 20-to-25 percent increase, after raising its rates between 40 and 100 percent in 1985. No one else risks any guesses.

The chart on pages 38 and 39 shows which carriers are offering coverage on an admitted or nonadmitted basis in your state. Companies operating on an admitted basis have met requirements specified by the state insurance commissions. The chart also shows which firms offer coverage abroad.

SIZE RESTRICTIONS

Schinnerer and DPIC, two companies that specialize in providing insurance for design professionals and have developed in close collaboration with industry trade associations (AIA/NSPE and ACEC,

Under which, if any, of the following non-traditional forms of practice will your company provide the architect with professional liability insurance?

	Architect as prime contractor	Architect as subcontractor to design-build contractor	Architect as turnkey contractor	Architect as design-build developer	Joint venture
Schinnerer	■	■	■	■	■
DPIC		■			■
Shand, Morahan					
PMI	■	■	■	■	■
Illinois R.B. Jones	■	■	■	■	■
INAPRO		■			■
Sheehan	■	■	■	■	■
PLU					
IMI		■	■		

The real question is, "Available at what price?"

respectively), pride themselves on offering coverage to all types of design firms. Schinnerer says, "We firmly believe our program is attractive to all sizes of architecture firms rendering a broad range of services." DPIC emphasizes that it is looking for firms with a good record and a commitment to loss prevention, and rates itself especially attractive to "the architect whose practice involves commercial/industrial/institutional projects and offers a full scope of services (including design with construction review)."

Some of the other primary insurers will rule out applications simply on the basis of firm size. INAPRO requires a minimum of $100,000 in billings and prefers "medium- to large-sized architecture firms that engage in traditional design practice."

Shand, Morahan doesn't have a minimum billings limit but, according to Douglas Bodonovich, assistant vice president, "Our minimum premiums rule out the really small accounts." Bodonovich says they're looking for "full-time practitioners," and are particularly interested in "medium-sized architecture firms ($200,000–$1 million fees) with established track records and excellent loss experience."

Illinois R.B. Jones has no limits, but "prefers small accounts [with] under $1 million in fees . . . with little exposure in government, school or medical work . . . and little or no loss history."

IMI has a $100,000 gross fee income minimum and a $5 million maximum, and PLU has a $6 million maximum. Sheehan states it has no firm-size restrictions and PMI is noncommittal, saying "such restrictions are subject to periodic revision."

Minimum and maximum liability limits

As explained above, the tightening of the reinsurance market has made insurance for higher limits of liability very hard to obtain this year. The chart on page 41 shows the minimum and maximum limits of liability each company reported as "available," but the real question is "available at what price?"

Carriers do not guarantee they will offer the higher limits of liability to existing clients, let alone to new business. Many have reduced the amount of coverage they are giving their existing clients from the amount they offered last year, even though the insured's risk factors have remained constant. The figures in the chart do show the ranges each firm works in, and are useful in that regard.

Nontraditional coverage

Offices involved in nontraditional forms of practice find the number of potential insurance carriers even more limited. The chart on page 37 shows who is offering what kinds of nontraditional coverage and project insurance.

It's important to understand that when engaging in anything other than private consulting, your standard policy may not apply. If you participate in a joint venture, obtain an ownership interest in a construction or development company (or it obtains an ownership interest in your firm), become an employee of an architecture firm or a contractor or developer or derive more than half your billings from a single client, you become "nontraditional."

For your protection, explain your exact circumstances to your insurance carrier and make certain that a tailor-made policy provides coverage for all the work you do. Again, there's no substitute for the help of knowledgeable brokers and attorneys.

Joint ventures, for example, need a rider—and have to pay an additional premium. All the coventurers may be required to carry liability insurance and to disclose the limits of their coverage to the insurer. You'll need to draw up a joint-venture agreement specifying the amounts of insurance each party is required to carry, and who will pay which proportions of deductibles, defense costs and claims. If one of your joint-venture partners is a developer or contractor, a completely different arrangement may be necessary.

Project insurance

Project insurance covers a specific project only. The policy typically covers the prime design professional and his or her consultants for any claims related to that project. Often the owner is contractually required to purchase the policy on behalf of the design professionals. At the end of a specified time, coverage ceases unless it is included under each design professional's basic policy. As with joint ventures, a clear agreement is necessary regarding issues such as who is

In which states do you write professional liability insurance on an
□ *admitted (direct) basis*
■ *non-admitted (indirect) basis?*

	Ala.	Alas.	Ariz.	Ark.	Calif.	Colo.	Conn.	Del.	D.C.	Fla.	Ga.	Hawaii	Idaho	Ill.	Ind.	Iowa	Kan.	Ky.	La.	Me.	Md.	Mass.	Mich.	Minn.
Schinnerer	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■
DPIC	■		■	■	■	■	■	■	■	■	■	□	□	■	■	■	■	■	■	■	□	■	■	■
Shand, Morahan	■	■	□	□	■	■		□	■	□	□	□	□	■	□	■	□	□	□	□	□	□	■	□
PMI	□	■	■	■	■	■			■	■	■	□	■	■	■	■		■	□		□		■	
Illinois R.B. Jones	□	□	□	□		□		□	□	□	□	□	□	■	□	□	□	■	□	□	□	□	□	□
INAPRO	■	■	■	■	■	■	□	■	■	■	■	□	■	■	■	■	■	■	□	■	■	■	■	□
Sheehan	■	■	■	■	■	■	■	■	■	■	■	□	■	■	■	■	■	■	■	■	■	■	■	■
PLU	□	□	■	■		■		□	□	□	■	□	■		■	■	□	□	■	□	■		□	□
IMI	■	□	■	■	■	■		■	■	■	■	□	■	■	■	■	■	■	■		■		■	■

responsible for what portion of the deductible, how long the coverage will last and the amount of coverage and deductibles. Project insurance is particularly suitable for joint ventures.

Only four insurance carriers currently offer project insurance. Schinnerer; DPIC; Illinois R.B. Jones; and Shand, Morahan. Schinnerer requires the prime professional to be insured with the CNA/Schinnerer program. Illinois R.B. Jones also restricts this type of coverage to existing clients. DPIC requires one member of the design team to be DPIC-insured (not necessarily the prime professional). Shand, Morahan indicates no restrictions.

All carriers reduce premiums for an architect's basic practice policy to account for billings applicable to separately insured projects.

Schinnerer is the only carrier currently guaranteeing coverage for the term of the project and a subsequent discovery period (five years) beyond project completion. The first $5 million in limits of liability can be canceled only "in situations in which the insured fails to pay the premium, fails to comply with policy terms and conditions or misrepresents facts in applying for coverage."

DPIC reserves the right to adjust policies as a result of changes in composition of the design team, term of exposure, construction values, design fees or scope of services. In addition, a 30-day notice of cancellation may be applied "if circumstances warrant such action."

Shand, Morahan writes multi-year project insurance policies "subject to annual rerate" and cancellation "which can be exercised by the company or insured."

Illinois R.B. Jones writes project insurance "one year at a time."

If you want first-dollar defense

You like to sleep at night. You don't want to even *think* about being sued, and if you are sued, you want your insurer to bear the entire cost of your legal defense and any judgments against you. Maximum deductibles under standard policies range from $2,000 (Schinnerer) to $5,000 (DPIC; Shand, Morahan; INAPRO; Sheehan). Unless a first-dollar defense option is procured, this deductible will apply to defense costs too, even if you win and no indemnity payment is made on your behalf.

It's available—at a price. Schinnerer offers it in all cases for bodily injury claims, and for property damage claims closed with no payment to the plaintiff by CNA or the insured. The surcharge "varies dramatically depending on the size of the limit and the deductible—easily 10 percent of the annual premium in some cases." Schinnerer offers first-dollar defense "only to small and medium-sized firms with good loss records."

DPIC offers a "shared expense program." For a surcharge based on the size of the policy's deductible, the insured will pay 20 percent of claims expense until the deductible is reached. DPIC pays the remaining 80 percent. The program is available to those with deductibles of $25,000 or less.

Illinois R.B. Jones offers first-dollar defense on all claims for a surcharge that varies, but is "usually 10 to 25 percent." The program is available to "the majority of insureds."

For a surcharge of 10 to 15 percent, IMI will offer first-dollar defense on all claims, for the first $10,000 of expenses. Availability is "subject to the claims experience, services and projects of the insured." Shand, Morahan; PMI, INAPRO; Sheehan, and PLU do not offer first-dollar defense.

Applying for coverage for the first time?

Most basic professional liability insurance policies are written on a "claims made" basis. They cover you for any claims made during the period that the policy is in effect. If you switch insurance companies, most will include "prior-acts coverage"—for claims brought during the policy period for work done prior to the policy period—at least to the extent that prior acts were covered by your previous carrier. But if you have never had insurance, obtaining prior acts coverage is not always possible, and when it is, will almost always require an additional premium.

DPIC, IMI and Illinois R.B. Jones are the only firms that offer prior-acts coverage to first-time insureds.

Schinnerer does not offer prior-acts cov[illegible] to first-time insureds or to firms that have not been continuously insured with Schinnerer for the past two years. Shand, Morahan doesn't offer

Miss.	Mo.	Mont.	Neb.	Nev.	N.H.	N.J.	N.Mex.	N.Y.	N.C.	N.D.	Ohio	Okla.	Oreg.	Pa.	R.I.	S.C.	S.D.	Tenn.	Tex.	Utah	Vt.	Va.	Wash.	W.Va.	Wisc.	Wyo.	Worldwide	Non-Communist	U.S. & Canada
■	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■		
■	■	■	■	■	■	■	■	■	■	■	■	□	□	■	■	■	□	■	■	■	■	■	■		■	□	■		
□	□	■	□	■	□	□	□	■	□	■	□	□	□	□	□	■	□	□	□	■	□	□	□	□	□	□		■	
	■		□	■			■			■	■	□	■	■			■		■	■	□	□	■	□	■		■		
□	□	□	□	□	□		□	□	□	□	□	□	□	□	□	□	□	□	□	□	□	□	□	□	□	□			
■	■	■	□	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■	□	■		
■	■	■	■	■	■	■	■	□	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■		
■	■	□	□	■	□		■		□	□	□	□	□	■		■	□	■	□	■		■	□	□	□	□	■		
■	■		□	■		■	■	■	□	□	■	■	■	■		■	■	■	■	■	□	■	■	■	■	□	■		

Loyalty counts with some insurers

prior-acts coverage if there was no prior coverage or if there was a gap in coverage Sheehan, PMI, PLU and INAPRO also refuse prior-acts coverage for first-timers.

SWITCHING HORSES IN MIDSTREAM

When you switch carriers, you have to make sure that prior acts are covered. All of the firms responding to our survey indicated that they do provide coverage for acts performed during the policy period of a previous insurer, but only if coverage was continuous, and only for circumstances that were not known to the insured when he or she first buys the new policy This prior-acts coverage is generally included in the base policies, and there is no surcharge unless there was no prior coverage or there was a gap in coverage

Loyalty counts with some insurers, and they will penalize you if you leave them and then reapply for coverage Shand, Morahan, for example, points out that those who reapply are "rated as a new risk and not as a renewal. The result would be higher insurance cost " Illinois R B Jones says, "We give credit for loyalty, which would not be applicable" if the insured switches carriers and then reapplies.

EXTENDED DISCOVERY

Extended discovery is a vitally important concept in "claims made" policies. Unless there is an extended-discovery clause in your policy, or you pick up prior-acts coverage from a subsequent insurer, you will not be covered for work you did during the policy period if claims are filed after you drop the policy.

Many states require extended-discovery coverage. Provisions vary widely from firm to firm. Here's exactly how the companies responded to the question. "Do you provide discovery coverage for insureds who leave your program? If so, describe terms and costs "

Schinnerer—"Yes. If the policy is canceled for any reason, except for nonpayment of premium, insureds in our program have the right to purchase a discovery period extension of coverage. The period of extension varies from state to state, but the most commonly avail-

Professional Liability Insurance Carriers

Presented here are brief descriptions of the nine insurers that participated in the AIA's 1985 professional liability insurance survey. The comments are based, in large part, on information provided by the respondents themselves.

The name of the insurance company is presented first; the underwriting firm is indicated second. Because the underwriting firms generally have more name recognition in the industry, their names were used in the article

CNA Insurance
Victor O. Schinnerer & Co., Inc.
5028 Wisconsin Avenue. N W, Washington, D.C. 20016
Homer Sandridge, (202) 885-9500

The oldest program in the business, having offered coverage for 28 years. Developed in close association with the AIA and the National Society of Professional Engineers. Commended by the AIA for offering broad and comprehensive coverage, good service Marked by comprehensiveness of program, including individual client consultations, active loss prevention programs. Insures more than 3,000 architecture firms—the largest book of business in the industry

All claims go to the central A/E claims office in Washington, D.C. The claims office establishes a claims file and assigns each to a specialist in one of Schinnerer's 48 claims offices throughout the country Claims service is provided worldwide

Design Professionals Insurance Company (DPIC)
(Insurer and underwriter)
P O Drawer DPIC, Monterey, Calif 93942
James V Atkins, (408) 649 5522

Begun in 1963 as a program for the Consulting Engineers Council of California through American Motorists Insurance Company Six hundred members of the American Consulting Engineers Council (ACEC) provided (in 1970) the capitalization required for DPIC to offer nationwide coverage. Program expanded in 1975 to include architecture firms, which now comprise 41 percent of business.

DPIC's loss-prevention program includes policyholder education through self-study testing programs, for which premium reductions can be earned, publications and seminars.

Business is generated by a network of 48 exclusive representatives. They visit all applicants to help with the application. DPIC handles claims initially by telephone. Follow-up is through personal contact from a DPIC claims supervisor or an approved defense counsel. Claims offices located in Monterey, San Francisco, and Newport Beach, Calif.; Chicago, New York City; and Decatur, Ga. Claims service is offered worldwide to the extent that coverage is worldwide.

Evanston Insurance Company/General Accident Insurance Company of America
Shand, Morahan & Company, Inc.
Shand Morahan Plaza, Evanston, Ill. 60201
Douglas Bodumovich, (312) 866-0821

At least temporarily, not writing or renewing A/E policies. Fifteen years in the business. Architecture firms account for about half its business. Offers a broad and flexible program "generally equal to those of its larger competitors " Claims staff in Evanston contacts insureds within 24 hours of a claim. May either send a company attorney or assign local counsel. Claims service offered worldwide

Fremont Indemnity Company
Professional Managers Inc (PMI)

able extension is a one-year period at an annual cost equal to the average premium over the last three years of coverage."

DPIC—"Yes. Such coverage is normally not provided except in the event of retirement, the disbanding of a firm or when such coverage is required by state statute. Terms and costs would be reviewed on a case-by-case basis."

Shand, Morahan—"No. However, our discovery clause permits the insured to report circumstances during the policy period. If these circumstances later develop into a claim, they would be covered in accordance with policy terms."

PMI/Fremont—"No, unless the company cancels or nonrenews the policy. (In that case, it is available for a) one-year period. Cost to be determined at time of cancellation or nonrenewal."

Illinois R.B. Jones—"Yes, if you mean retired insured. Depends on reasons and circumstances. Annual claims-made form [is] restricted to work while we were actively on risk, must be continually renewed until insured feels no longer needed."

What are the minimum and maximum limits of liability available through your company?

	Minimum	Maximum
Schinnerer	$100,000	$15 million*
DPIC	$250,000	$ 5 million
Shand, Morahan	$100,000	$ 5 million
PMI	$250,000	$ 5 million
Illinois R.B. Jones	$100,000	$ 1 million
INAPRO	$100,000	$10 million
Sheehan	$100,000	$ 2 million +
PLU	$100,000	$ 5 million
IMI	$250,000	**

*"higher amounts are individually negotiable"
** "subject to excess capacity available from other markets"

2 North Riverside Plaza, Chicago, Ill. 60606
Brenda Phillips, (312) 559-5170
Not currently writing A/E policies. One of the newcomers in the industry, in business for four years. Design firms represent 30 percent of total book of business. Sixty-five percent of those are architecture firms. When a claim is filed, PMI's claims office in Chicago sends a written response to the insured within one week, unless immediate telephone contact is deemed appropriate. Local attorneys or adjusters are sometimes retained by Chicago staff. Claims service offered worldwide. PMI does not offer a formal loss control program.

Lloyd's of London
Illinois R.B. Jones
175 West Jackson Blvd., Chicago, Ill. 60604
M. Linda Dess, (312) 435-8200
Stopped writing A/E policies Oct. 15, 1985. Will reevaluate November 1. Fifteen years in the market, 450 architecture firm clients represent 70 percent of business. Lloyd's is a far more conservative firm than generally thought—it takes on unusual risks (like Betty Grable's legs), but not excessive risks. Claim form mailed to Chicago office. Legal counsel in New York City supervises and assigns local counsel if necessary in the United States and Canada.

CIGNA and Pacific Employers
INA Underwriters Insurance Co. (INAPRO)
127 John St., New York, N.Y. 10272
Louise Kandel, (212) 556-5000
Eleven years underwriting experience for architects and engineers. Stopped writing A/E policies in March 1985, but started writing again at the end of September. Reinsurance requirements have led to a more stringent selection criteria, now writes approximately 25 percent of the applications received. About 60 percent of total business is architectural. Claims offices in New York City and Los Angeles. All claims must be reported to New York office, which may handle directly, assign to regional office or refer to independent adjuster. INAPRO appoints defense counsel for all litigated matters. Method of response depends on individual case.

Imperial Casualty & Indemnity Company
Thomas F. Sheehan, Inc.
801 North Plaza Dr., Schaumberg, Ill. 60195
Thomas F. Sheehan, (312) 490-1400
Fifteen years in the business. More than 60 percent of its 2,400 design firm clients are architecture firms, representing 40 to 45 percent of total business. All claims are handled by local counsel assigned by the Chicago office.

Rockwood Insurance Company
PLU, Inc.
35 East Wacker Drive, Suite 1934, Chicago, Ill. 60601
William Turner, (312) 372-1071
In the market since 1981. Formerly wrote through Pine Top Insurance. Fifty percent of 1,500 design-firm clients are architecture firms. Claims are filed through PLU, Inc. in Chicago and sent to a claims adjusting organization. Local counsel is retained when necessary.

Republic Insurance Group
Insurance Management Inc. (IMI)
3166 Des Plaines Ave., Suite 102, Des Plaines, Ill. 60018
Patricia Talkington, (312) 296-5030
Four years in the business. Fifty percent of total business is architecture firms. Claims reported to claims department in Des Plaines, which promptly acknowledges receipt of claim in writing. Local attorneys are assigned when necessary.

elegant marble finish

Liability Insurance Primer

BY BURTON W. THOMAS, AIA

How many architects really know why they have professional liability insurance, or whether they need it at all?

Though altogether a very complicated subject, most architects questions about liability insurance distill down to six:

- *How does the insurance work?*
- *How are prices set?*
- *How much coverage is required?*
- *What should my deductible be?*
- *What should I look for in an insurance carrier?*
- *What should I do if I have a claim?*

This primer represents a brief response to each of these.

TO ERR MAY BE HUMAN, BUT IT IS CERTAINLY NOT PART OF THE mindset of most American architects. Indeed, the fact that one in three design professionals gets sued each year strikes most of us as surprising no matter how many times we've heard it. In response, we tend to cast indignant glances at other practitioners sooner than reassess our own positions.

This mentality of flawlessness leaves many architects feeling that professional liability insurance is, at best, a necessary evil. But the very nature of architecture, wrought in innovation and dependent on the work of many, makes mistakes neither shameful nor an altogether unlikely occurrence.

A large number of lawsuits brought against architects may be groundless, but the regularity of those that are not makes professional liability insurance essential for most well run architectural firms. As insurance companies know, the probable frequency of mistakes can be calculated by relatively empirical methods—and the chance of error is always present. This accounts in large part for how professional liability insurance works, why it is necessary, and how premiums are set.

Burton W. Thomas, AIA, practices architecture in Concord, New Hampshire.

This article is based on the work of the AIA's Architects Liability Committee, of which Mr. Thomas is a member.

PROFESSION

Project types affect premiums

HOW INSURANCE WORKS

Almost all of the insurers of architects are large companies which rely on a mix of many different kinds of insured risks in order to maximize their profits. Because they have so many lines of insurance, they rely on outside specialists—underwriting managers—to appraise the risks and report on pricing.

The underwriter selects the risks for which they are answerable and rates those risks in terms of acceptability. In our case, we and our practices are the risk, and the acceptability is a major determinant of the fee (premium) we pay.

Insurance companies, in turn, lay part of the risk they assume onto "reinsurers." Reinsurers are investors who insure the insurer. They usually cover the top end of claims—in insurance lingo, they choose a higher level of risk. This means they pay the big dollars awarded in major liability claims but pay out nothing for the smaller, more frequent awards.

Let's say that your coverage is for a dollar, with a 5-cent policy deductible. You insure yourself, in effect, for the first nickel. The insurer, for whom the underwriter works, might cover from the nickel to the half-dollar. The reinsurer covers from that point up to the policy limit. The reinsurers receive only a small portion of the premium paid, but most claims end short of their responsibility.

Actually all policies covering architect's professional liability are written on an annual basis, providing coverage for 12-month periods. All such policies are "claims made." This means the policy must be in force at the time a claim is made and, unless specifically stated in the policy, also in force continuously since the time the services were rendered from which the claim arose.

Under a claims-made policy, it is wise to report even a suspicion of a claim as soon as you discover it. Most insurance companies will accept this as the trigger for the policy, thus providing coverage for that claim even if you later leave the program. Further, most do not adjust your premium for reporting a *potential* claim.

When coverage is renewed from year to year with the same insurance company, coverage for prior years is normally carried forward. Most policies also include "prior acts" coverage as an optional provision of the standard policy. This covers claims for services performed while insured by a different carrier, as long as you had no knowledge of the possibility of the claim arising at the time the new policy was written.

Under a "claims-made" policy, all coverage ceases when the policy is canceled or not renewed (some states have special provisions for non-renewal). This makes it difficult and often unwise to change from one insurer to another. Questions regarding responsibility for coverage and claims invariably arise in this situation, leaving the architect between the proverbial "rock and a hard place."

HOW PRICES ARE SET

Premiums indicate how the insurers interpret the level of the risk. They are based on several factors, the most important of which is the insurer's loss ratio. Loss ratio is determined by dividing the anticipated losses by the available monies taken in as premiums.

Underwriters consider two kinds of loss ratios. The first is paid loss ratio, which is the ratio of "paid losses" (claims for which the company pays) to total premiums collected. The second is incurred loss ratio, which is the ratio of paid losses plus "claims reserves" to total premiums.

Claims reserves are monies placed in an escrow-type account by the insurance company when a claim is first reported. It is an estimate of the anticipated loss and is required by law. The amount of the reserve is adjusted as the nature of the claim becomes clear and the potential liability is evaluated. The reserve reflects the insurer's best estimate of the total amount it may pay in indemnity and expenses to resolve a claim.

Insurance companies must be realistic in estimating claims reserves. An audit by a state insurance department may direct them to add to the reserve. If the cash isn't there, problems could come up which would be difficult if not impossible to overcome.

Loss ratios can be seen as outside the insured's (your) control. But other factors which affect premiums have more to do with the individual firm.

- *Billing volume.* The amount of your firm's billings in the preceding year greatly affects the amount of your premiums for the next.
- *Project types.* The type of work you do also affects the premium. If you undertake studies, master planning or interior design, your premium would be somewhat less, because these areas of practice are considered to have less exposure to liability. If you design hospitals or laboratories, your premium may rise.
- *Geographic location.* If you work in a state which has had poor loss-experience, your premium will be higher than if you practice in a state with a better claims record.

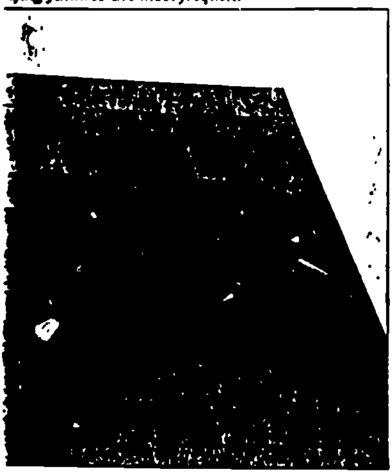
Insurance companies convert these factors—firm size, project type, and location—into what is called the *billing base premium*. Then they consider certain activities which are not part of the basic policy. These are called exclusions. If you engage in activities which require coverage but are "excluded" by the basic policy, a surcharge is added to your billing-base premium to provide that coverage. The total of the billing-base premium and the additional charges for removal of exclusions (or adding certain types of coverage, if you prefer) creates the *total manual premium*.

Two other factors come into play at this point.

- *Professional activities.* The scope of professional services of the firm affects premiums based on general loss experience for those endeavors. If you are an A/E firm, for example, your premium will be different than if you are a firm that supplies architectural services alone.
- *Individual record.* An insured's individual loss experience is also reviewed, including the record of paid and pending claims. Underwriters consider both the amounts involved and the frequency or number of claims. Simply reporting claims does not affect the premium, unless the number becomes excessive. The total claims experience is reviewed in relation to the tenure in a particular program and the total paid-in premium. Rating credits are applied to the manual premium and can be as high as 25 percent over a period of a few years. The opposite is also true—the worse your experience, the higher the premium.

These factors, applied to the manual premium, create the *total ba*

ofing failures are most frequent



Moisture in the joints ruined this facade

premium To obtain the actual premium paid by the insured for a given limit of liability and deductible for the policy, a final multiplier is applied to the total base premium. The result is the *standard premium*. The multiplier used varies depending on the combination of limit (the amount which the insurance company will pay out on your behalf in a given year) and deductible selected. For a given limit, the factor decreases as the deductible increases. For a given deductible, the factor increases as the limit is raised.

Simply put, this process is as follows:
BILLING-BASE PREMIUM
(project billings, project types and office location) +
Additional charges for removal of exclusions =
MANUAL PREMIUM +
Rating credits for type of services and claims experience =
TOTAL BASE PREMIUM ×
Multiplier for limit of liability and deductible =
STANDARD PREMIUM
(the premium your firm pays for the selected coverage)

There is one other factor that affects premiums—the company you choose to insure yourself. Different companies have different premium rates. These are based on history in the marketplace, return on investment, long term corporate goals and services provided. When you purchase a policy, you are buying more than just protection. How your insurer handles your claim might ultimately be more important than how much or how little you paid for your policy. The depth of services they provide varies and may alter premiums.

In addition, the company's relationship and reputation with its reinsurers affects premiums. Your insurer is essentially buying insurance for you from reinsurers, many of whom are in Europe. How they view performance and risk is significant.

Some underwriters and carriers use pricing strategies and terminologies that are somewhat different than the methodology described here. However, the factors that affect policy are consistent throughout the industry.

How much coverage is required?

Many clients think an architect's coverage should reflect the full value of their projects. This is rarely wise or realistic and is always very expensive. It is more reasonable to assume that coverage should be "appropriate" for the type of practice and the firm's gross revenues. For example, a medical center is more likely to have a claim than a residence, and a large firm can obviously afford to carry higher coverages than a small firm. These considerations are typical of the factors that determine appropriate coverage.

AIA components report that the vast majority of firms have coverage of no more than $250,000. It is not unreasonable to carry only $100,000 in the first five years of practice if your firm is relatively small and your gross billings are low.

It is a rule of thumb to have coverage which is not less than your gross annual billings, but many insurance professionals advise "buying as much as you can afford."

The same factors that affect premium also apply to the amount of

Rules-of-thumb on coverage

coverage If your firm has frequent claims or you live in an area with frequent claims against architects, you should increase your coverage. Like all decisions regarding insurance the amount of coverage is a business question only you can answer: How much are you willing to expend for protection against the possibility of loss? You should also be sure that your consultants have coverage If not, and a claim should arise, then your exposure increases because the party making the claim will look for the insured first.

Deductible amounts

All policies have a deductible amount—your self insurance The deductible amount you select depends on two opposing business instincts. First is the desire to have the largest amount of the risk passed to the insurer—a low deductible Second is the recogniti that when the insurer carries more risk, you pay more Some in ance programs allow deductibles of as low as $2,000, but most f carry a much higher amount.

Other factors to consider are defense cost options and specia visions for deductibles. With some policies the deductible applie all claims, both bodily injury and property damage With others deductible does not apply to defense costs incurred for claims ir ing bodily injury or death without property damage (unless chan by an endorsement which reduces the premium) Since many cl arise from injuries during construction, this can be an important aspect of your policy

Your policy may also have a provision to eliminate the deducti

Alternative Insurance Options

There are many reasons for an insurer to refuse to provide errors and omissions insurance a bad claims record, a bad-risk practice (such as nuclear power plant design), a potentially risky, but unproven practice (such as asbestos abatement) and even the fact that a practice is incorporated in an area with a history of frequent litigation. The obvious question that arises when one cannot get insurance is. Where can I go from here?

There are three options to conventional errors and omissions insurance practicing without insurance ("going bare"), self insurance and joining with colleagues to form a mutually insuring association.

For small firms, going bare is often the only recourse to insuring with an established carrier because of the money and expertise needed to pursue other options.

Each individual should compare the protection and cost of an insurance policy with the likelihood of claims being made One small-town Mississippi architect, who requested to remain anonymous, gave an example of how difficult such a comparison is. His one-man office designed low risk, mostly residential projects, he practiced with good professional care and contracted with competent consultants whenever necessary Thinking that risk of a large claim was small, he practiced eight years without errors and omissions insurance before a spurious lawsuit opened his eyes. "It was horribly distasteful seeing people looking for free money," said the architect's office manager, who is now actively seeking an insurance carrier

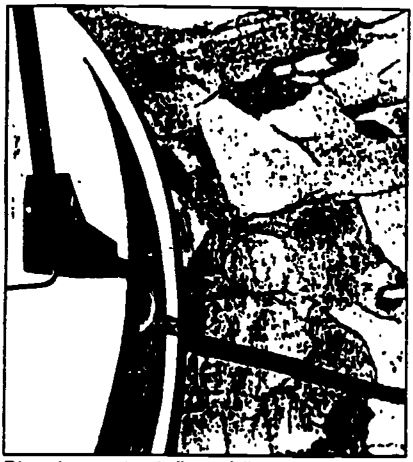
Self insurance differs from going bare because it requires an actuarial study and a reserve fund specifically meant to cover potential claims Regulations vary from state to state but generally require a certain percentage of billings, or an amount equal to expected losses, be set aside Self insurance may be a preferred option for very large architectural firms, which can more easily absorb the setup and maintenance costs than a small or medium sized practice

Those too small to adequately self insure can turn to collective insurance ventures such as captive insurance and mutual insurance

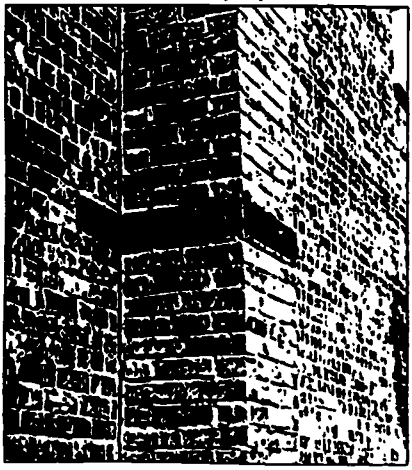
To form a captive insurance company, a group of professionals with similar practices combine financial resources for a sort of group self insurance Captive insurance companies are state regulated, which means they cannot cover interstate practice, are restricted to professionals registered in the state and often do not qualify for the insurance requirement in government procurement. Some interstate practice regulations can be circumvented by incorporating a captive insurance offshore For instance, The Association of Wall and Ceiling Industries-International has formed Hereford Insurance and Surety Co., Ltd., a captive insurer out of Hamilton, Bermuda, which has a $1-million-deductible reinsurance policy with Lloyds of London

To decrease the risk of drawing claims captive insurance ventures are set up with specific membership requirements For example, a Bermuda based captive insurance cooperative made up of geotechnical engineers requires that each insured firm be active in the Association of Soil and Foundation Engineers (ASFE) peer review program, send an attendee to one or more ASFE meeting per year and incorporate ASFE loss prevention strategies

Forming a mutual insurance company is the recourse of corporations that *must* have specialized insurance and can get it no other way A mutual insurance company is conventional in every way except that it is owned by the insureds and therefore requires a great deal of capital and commitment from those forming it An example is Asbestos Research Group Inc. (ARGI), a group of asbestos-abatement contractors based in Louisiana who need insurance that is per-occurrence rather than claims-made (so that each project will be covered individually, instead of having protection against claims only as long as the insurance policy is in effect) ARGI members also want to qualify for government projects With over a year of study behind them, ARGI has concluded that only by buying an insurance company will they meet their criteria But the lack of actuarial data in asbestos abatement work and the difficulty in securing a reinsurance policy has thwarted their efforts so far —*D E G*



Electrolytes made this (beautiful) pattern



Chimneys must be keyed in sooner or later

for defense costs on property damage claims when no indemnity payment is made by you or your insurer. There is usually an option called "first-dollar defense" which, for an additional premium, eliminates the deductible even if an indemnity payment is made. Also, depending on the policy terms, the deductible may or may not apply to the cost of investigating claims.

Recent history has proven that the costs for some of these options fluctuate from company to company and even within the same company as a performance record is developed. You should be aware of all the deductible options offered and study your firm's risk and cash requirements should a claim be settled against you.

When choosing a deductible, it is important to remember that an insurance policy is intended to protect against serious financial losses. One major claim could put a firm without adequate protection or resources out of business. However, an insurance policy is not designed to cover every minor claim which arises.

In general, a firm's deductible should be directly related to its volume of work and a review of its finances, especially cash flow. A deductible that is too low threatens a firm's loss record. It burdens the insurance company with the cost of minor claims and adjustments which a firm feels should be volunteered on a given project. This would result in a less favorable experience record which would in turn be reflected in a higher premium.

But a deductible that is too high also poses problems. This could really strain a firm's finances in the event of multiple claims, since the deductible applies to each claim made during the policy period.

The underwriter reserves the right to assign a deductible based on firm size, claim experience and other factors. However, the firm's own request is usually accommodated as much as possible.

Choosing a carrier

Critical to any evaluation of insurance carriers must be an analysis of what their response will be in the event of a claim. Claims handling ability and procedures are every bit as important as price. A low premium may be meaningless if your carrier does not respond promptly, efficiently and economically to protect your interests.

Claims handling

Factors which should be considered when judging claims handling capabilities are:

- How promptly and in what way does the carrier respond when a claim is reported?
- Do those who will handle the claim have direct experience in architect's professional liability?
- Does the carrier have local claims offices or are claims administered from a central office?
- How are defense lawyers selected and what are their qualifications in architectural liability cases?
- Is there a program for educating claims personnel and defense lawyers about architects and the construction industry?
- Does the insured have any recourse to the insurance underwriting manager for assistance if there is a problem with the handling of the claim?

Ask your broker all of these questions, and if, as is often the case,

Price is only part of the equation

When Claim Time Comes

What should you do if there is a claim against you? It is probably a good idea, before doing anything, to consider calling your lawyer. Then:

- Remain as calm as possible
- Notify your carrier, through the underwriter, in writing. If the circumstances indicate that immediate counsel is needed, call your underwriter.
- Cooperate fully with your insurer. Refusal to do so may result in the cancelation of your policy
- If the claim involves a traumatic situation, such as a collapse or bodily injury, and if you are able, take photographs. Your photos, taken promptly after the incident, are of more value than professional photos taken later.
- Once the claim has been made, do not attend or agree to attend any conferences set up specifically for the purpose of discussing this claim without first consulting with your claims representative
- Do not sign or accept any releases from any parties without approval from the claims representative
- Commit to writing, when directed by counsel or the insurance company, the circumstances of the claim which are known to all involved. Do this as soon as possible after the incident.
- Assemble, in chronological order, all pertinent agreements for services, all correspondence, memoranda, etc., without comments or argument
- DO NOT ADMIT (or even imply) LIABILITY—do not attempt to place blame

the local broker does not know the answer, write directly to the carrier. Talk to your peers about their experiences. Remember, you are purchasing a product and are entitled to know.

Defense procedures

When claims arise, you should expect your carrier to provide immediate support and precise direction as to what you should and should not do. They should provide a clear, understandable explanation of the legal ramifications and financial consequences you face and render opinions regarding whether to defend or settle the claim.

All policies include defense of your claim. Who does this and in what manner is the true measure of your insurance carrier.

Some companies have specially trained claims representatives. Others delegate defense to local attorneys. Still others send their own technical consultants to assist. You may prefer immediate legal help by experts, in spite of the costs that begin to accrue. You might also prefer the local paralegal help provided by claims representatives. The value of the latter is often determined by the length of time the company has been in the market and their record of performance in defense.

Depending on your carrier, your policy may permit the insuranc company to settle a claim without your consent. Most policies require the insureds consent before a claim may be settled, but if yours does not, then you have lost some protection and given the authority to affect your financial future to others.

The broker

Your broker is another important factor in the equation of insuranc Be sure that he has experience with architects. The "friendly neig borhood" insurance agent may not be the right person to advise y on liability matters.

Professional liability insurance for architects is specialized. The are relatively few companies offering it. Some who have offered it the past are no longer in business and some offer substantially low premiums in an effort to sell more policies. That is one reason wh some of them are no longer in business—they cannot afford the lo haul which liability insurance coverage requires. An insurance com pany's, and the underwriters, experience and tenure in the busine is an indication of capability and commitment to a difficult area of s vice. This is not to say that a reputable company has to be "old" ir this area of coverage, but if the carrier or underwriter is relatively new, research and questioning are all the more important.

Reliability

Developing reliable data on claims and loss experience takes time. Even with statutes of limitation, claims can be brought years after project is completed, and then take years more before they are resolved. This long "tail" makes it difficult for the number crunche of the insurance world—the actuaries—to project necessary rates.

Actuaries must predict the future—estimating the amount of pa out the company will have to make on claims for which the premiu has already been paid, sometimes years in advance. The accuracy their estimates won't be known for years, but it has a great effect an insurance company's profitability.

With many years experience in this field, an actuary's projection become more reliable. Few companies have been willing to stay the course long enough to develop solid data. Several have recognized the rate-making problem and have stopped writing architects liabi insurance altogether, particularly after writing policies with unrealistically low premiums in order to be competitive.

Experience and longevity are important for another reason—the carrier must be in business when a claim arises. Losses in our profession can be referred to as "catastrophic" in their character and financial amount. If a company has limited assets, a few large claim can severely affect ... ancial condition. Even with reinsurers tak a significant portion ... the risk, the primary carrier must have suffi cient strength to cover its exposure.

Remember, if the insurance company decides to stop writing architect's liability insurance, all coverage for future claims, arising out of past work under this type of policy, stops.

The one exception to this situation is a provision for "extended discovery," which binds the insurance company to provide coverage for claims reported after the policy ends, as long as you report the possibility of a claim prior to termination. For those architects who

ike to sleep at night, that is not an easy thing to do No one wants to worry about reporting *possible* claims because the company that has your policy might not stay in the business.

Historically, the "extended-discovery" provision is rare This makes the longevity of the carrier all the more important.

Choosing the best

All in all, it is not easy to evaluate the financial strength of a potential carrier. The easiest and perhaps best (no pun intended) method is to ask your broker to check the insurance company's "Best" rating. This rating is provided by A. M. Best Company of New Jersey though not geared specifically for the insurance industry, Best provides financial summaries for all major insurance companies

You may also write to your state insurance commission, which has information on those companies that operate on an "admitted basis" in your state. Companies operating on an "admitted basis" have been accepted by the state commissions and are in turn required to furnish information about their products and financial stability

Finally, it is important, though not essential, that your carrier have a quality-control/loss-prevention program Such programs can offer very valuable guidelines for avoiding claims when it matters most—in practice. They also indicate the commitment the carrier has made to architect's liability insurance. These programs cost the company money but ultimately help the carrier reduce its losses—a savings passed on to practitioners in the form of stabilized rates ☐

The companies which are in the business of selling architect's professional liability insurance change often, as do the quality of services they provide To help AIA members remain informed the Architects Liability Committee periodically surveys all major carriers

For a number of years, the AIA has commended the insurance program of CNA as administered by Victor O. Schinnerer & Co, Inc, and it continues to do so. CNA has the only program to meet all criteria for commendation One of these is availability to membership in all states. In those states where other coverage is available there may be other carriers that meet the remaining commendation criteria

The commendation selection criteria, most recently modified in 1976, include the following requirements

that the insurance company be able to provide coverage and local claim service anywhere in the country.

that the reinsurers be of satisfactory financial strength.

that the insurance company possess the highest possible financial rating, as reported by A M Best:

that the insurance company make no changes in the terms or rate of policy without prior consultation with the AIA.

that the AIA has the right to examine the books of the insurance company and the administrator as these pertain to this program,

that the policy be available to all members possessing satisfactory experience- or performance-records

The last survey was conducted in Spring 1983 and a new survey is underway as of this writing The results will appear in a future issue ARCHITECTURAL TECHNOLOGY *Interim questions may be addressed Richard Rush (202) 626 7589 —M R*

Robert Wilson

Sealant failure is never pretty

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PROFESSION

Liability insurance has its own language

Glossary of Insurance Terms

Act of God—An event resulting from the forces of nature, without human intervention and that could not have been prevented by reasonable care.

Actuary—One who works with the mathematics and statistics of insurance in calculating premiums, reserves and related values.

Adjuster—One who settles insurance claims, who may or may not be a regular employee of the insurer

Admitted Carrier—An insurance company authorized and licensed to do business in a given state

Agent—A representative of an insurance company or companies. The authority under which the agent operates is delegated through an agency contract. The agent operates on behalf of an insurance company or companies with authority to solicit, negotiate and effect contracts of insurance

Aggregate Limit—The total amount payable under a policy, regardless of the number of claims

Arbitration—Formal, contractually agreed-upon process of resolving a matter of dispute by presenting the matter to specified impartial persons for a binding judgment.

Assumption of Risk—An agreement, expressed or implied, where a party becomes responsible for the risk involved in fulfilling an agreement or contract. Claimants who have assumed risk cannot collect damages if it can be reasonably assumed that they were aware that a hazard existed, yet proceeded with action.

Binder—A temporary insurance agreement pending issuance of the policy contract. The terms of the binder are implied to be the same as the policy to be issued.

Broker—Representative for the insured in the solicitation, negotiation or procurement of contracts of insurance. May also render services incidental to those functions. By law, the broker may also be an agent of the insurer, for purposes such as delivery of the policy or collection of premiums

Claims-Made Policy—A policy that covers only those claims that occur and are reported during the policy period which includes the entire time since the original claims-made policy was placed with the insurance company, as long as the policy was continuously renewed.

Deductible—A provision requiring the insured to pay a specified part of the loss

Due Care—The degree of care that an ordinarily careful and prudent person with the same skills and knowledge would exercise under similar circumstances and in the same community

Excess Insurance—Provides a higher limit of coverage than that provided by the primary insurance, and goes into effect when the loss exceeds the limit of the primary insurance.

Excess & Surplus Lines Carrier—An insurance company that deals in risks or portions of risks for which there is no market available through an admitted carrier in a particular jurisdiction. This type of insurer is nonadmitted with coverage being placed on an unregulated basis in accordance with the surplus or excess lines provisions of state law

Exclusion—Coverage that is specifically eliminated from an insurance policy

Frivolous Suit—A suit that is clearly without basis in fact

Hazard—A condition creating or increasing the probability of a loss

Hold-Harmless Agreement—A contract where one person assumes the legal liability of another

Indemnity—Payment by an insurer to a claimant that covers the entire loss

Insured—Under a liability insurance policy, the party to whom or on whose behalf benefits are payable

Lapse—To allow a policy to run out without renewing.

Liability—A debt or responsibility; an obligation resulting from a contract or tort

Loss Frequency—The number of claims made against a policy during a premium period

Loss Ratio—Net losses divided b premiums

Material Representation—A st ment, such as on an application for in ance, that affects the underwriter's decision in issuing a policy. A material resentation that is proved false may n policy coverage.

Misfeasance—The failure to perf a professional duty

Negligence—Failure to excercise care when there is a legal duty to use care, a breach of that duty and an inju damage

Nonadmitted Carrier—An insur company not licensed to do business i jurisdiction in question

Occurance—An accident or expos to injurious conditions during the polic period that results in bodily injury or p erty damage that the insured neither expects nor intends

Permissable Loss Ratio—The h est percentage of premium income an insurance company can pay for claims without losing profit

Policy Reserve—Funds an insur company allocates specifically for mee its policy obligations. Together with fu premiums and interest earnings, policy reserves enable a company to pay all future return premiums and losses

Producer—A marketing person w may be an independent agent, an excl agent, a sales person, a direct writer o field representative.

Reinsurer—A party to whom a pr sional liability insurance company pass all or part of the liability for risk. For example, an insurance company that p vides $2 million coverage may pass to reinsurer all risk above $1 million.

Release—A document by which th claimant abandons the claim either because of satisfactory payment or rec nition that the claim is invalid

Tort—A violation of right not arisin from a contract

Underwriter—Evaluator of risks determines rates and coverages for th

Mr. FLORIO. Thank you very much. Mr. Reed.

STATEMENT OF WILLIAM REED

Mr. REED. Mr. Chairman and members of the subcommittee, my name is William Reed. I am the vice president and treasurer of Williams College in Williamstown, MA. I am here today on behalf of the National Association of College and University Business Officers, NACUBO, and the other higher education associations listed on the cover of my testimony, together representing virtually every college and university in the Nation.

In addition to the associations listed on the cover of my written statement, the following associations join NACUBO in this testimony; the National Association of Independent Colleges and Universities and the American Council on Education.

It is my pleasure to be here today to discuss the concerns of the higher education community about the current insurance crisis and to offer our support and help as this committee develops a Federal response to the crisis.

With the chairman's permission, I would like not to read my report into the record, but to comment on the main points of it.

In your letter of invitation to this hearing, you mentioned two main problems facing colleges and universities. That is whether colleges can afford traditional insurance coverage and more importantly, whether they can even obtain it. I would like to also discuss briefly what colleges and universities are doing today to meet this crisis and what we think would help the colleges and universities through legislation.

First, the cost of insurance. The educational sector, as you know, is a very large user of insurance. By the nature of our business, we are very complex and broad based institutions. We need virtually every type of insurance available, not only your traditional liability and casualty and property insurance, but also medical, malpractice, day care insurance, hazardous waste insurance, and so forth.

I can tell you that the increased cost of insurance has had a dramatic impact on colleges and universities. Williams College has had our insurance canceled not because of loss experience but rather because our national carrier decided not to insure colleges and universities.

Using a national broker, we canvassed the market, including London, but could not find an underwriter to write insurance for our primary coverage. Finally, at the 11th hour, we were successful. However, our cost went from $85,000 to slightly over $300,000 for reduced coverage.

The College of Wooster in Ohio had the same experience. Their cost went from $88,000 to $250,000. University of Southern California had a $100 million earthquake policy with a $10 million deductible. The cost of their insurance was $12,500. When it came to renewal time, the cost of that same insurance was $400,000. Needless to say, USC has dropped that coverage.

These sudden increases in cost play havoc with college administrators throughout the country. Every business officer I know has experienced a dramatic increase in the cost of their insurance.

What it means is the opportunity costs we must face is either we raise tuition or we eliminate educational programs.

Wealthier schools, well endowed schools, can absorb the costs much easier than the smaller independent colleges. Many schools throughout the country have small endowments. If they cannot get insurance, they are faced with two prospects, either to face the risk of going uninsured and the potential for going out of business if they would be so unfortunate as to have a liability suit they could not cover, or to dramatically increase the cost of their program to in essence self insure.

The university officers that I know equate the current insurance crisis to the oil crisis of several years ago. It is having the same type of impact on how business is done and on budget considerations.

Addressing the availability of insurance for colleges and universities, the situation gets worse. Even the most prestigious universities are facing problems. Princeton University had its trustees and fidelity bond policies canceled in 1985. Hood College also had its directors' and officers' liability coverage canceled.

The coverages that are most difficult for colleges to obtain at the moment are trustees' and officers' liability, sports participation, liquor law liability, and automobile liability.

Let me mention a significant impact of the trustees' and officers' liability problems on colleges. As you know, all colleges in our country have boards of trustees who serve without pay and often put in many hours of service to the college. Their task is to help define the educational mission of the school and to oversee the broad policies of the college. Now for the first time these volunteers stand at risk, personal risk, if they serve on college boards. They want to serve but the first question they have to ask is, what is our liability coverage?

Over the long run, if we cannot entice the best minds and the best individuals in this country to serve in a voluntary capacity to the colleges and universities, this I would say will have a dramatic impact on the quality of our colleges.

Twenty-three colleges in the Northeast are working together to form a captive insurance company. One of these colleges just called me to tell me that they had just lost their trustees' and officers' liability and are currently going without. Another college at the moment cannot get liquor liability and has had to close down its student activity center. Another college is having difficulty in getting athletic insurance and is pondering what to do with its athletic program. I could go on and on.

The problem is there appears to be no simple answer. What are colleges doing for themselves? First, a few I am sad to say, have decided to drop traditional coverage altogether and to "go bare." These colleges are at great risk. Second, the vast majority have decided to accept higher prices, higher deductibles, less coverage and lower limits and wait for the crisis to dissipate, which many predict will take between 3 to 5 years.

To meet these higher costs, they have had to increase tuition and cut back on educational programs. A number are trying innovative approaches. They are utilizing self insurance in combination with

commercial insurance. They are creating captive insurance companies with like institutions getting together to try to form a group.

NACUBO is trying to help this effort as best it can. As a matter of fact, the insurance crisis has become one of the top priorities for the organization for this year. It has established a task force to study the issue. The things the task force is undertaking is to advise colleges as best we can on short term answers to problems. The phones are ringing off the hook at NACUBO with questions from both college administrators and trustees asking, where can I get insurance? I'm afraid there are not many answers. NACUBO is assisting colleges in developing consortium and setting up group purchasing arrangements. NACUBO is also being very instrumental in establishing risk management programs for smaller schools.

One member of our task force has taken the aggressive stance and is working hard to establish what we call a supertrust that will provide directors and officers of colleges coverage for all colleges and universities.

Also the task force is investigating the feasibility of establishing a national insurance company to provide excess liability.

What does NACUBO recommend for legislative action and change? First of all, it is obvious that colleges, like most businesses, need insurance coverage, at a fair price, free from wild swings in cost.

We would like your committee to look at the following areas; claims history. Premiums should be based on a client's loss history and background. We find that the colleges and universities generally are very good risks but the increase in premiums has nothing to do with the loss ratios.

Policy cancellations; we would hope there would be a law to require insurance companies to live to a signed agreement they have signed. A particular policy enabling an insurance company to cancel with 60 to 90 days notice, particularly when the contract is for an annual renewal is particularly grievous.

We also would urge the committee to look at the whole re-insurance process. One thing we have found in seeking insurance is that a common response is, we have been to London and they don't want to write this insurance. It seems to me a national problem when we have to go offshore to get re-insurance for colleges and universities.

The other initiatives that you mentioned today are very encouraging to us. We hope that you will pursue actively the Risk Retention Act which will help us in establishing captive insurance companies and consortium. We also hope that you will look into the areas of tort reform and to do whatever you can to help reduce the terribly litigious society we live in and to make it an environment where the first question that is not asked is how much can I sue for?

I would be happy to answer questions. Thank you.

[The prepared statement of Mr. Reed follows:]

NACUBO National Association of College and University Business Officers
One Dupont Circle, Suite 500, Washington, D.C. 20036-1178 • 202/861-2500

STATEMENT BY

WILLIAM REED

VICE PRESIDENT AND TREASURER

WILLIAMS COLLEGE

before the

U.S. HOUSE OF REPRESENTATIVES

COMMITTEE ON ENERGY AND COMMERCE

SUBCOMMITTEE ON COMMERCE, TRANSPORTATION AND TOURISM

HONORABLE JAMES J. FLORIO, CHAIRMAN

MARCH 19, 1986

On behalf of:

The National Association of College and University Business Officers

and

The American Association of Community and Junior Colleges

The Association of Catholic Colleges and Universities

The Association of Community College Trustees

The Association of Governing Boards of Universities and Colleges

Mr. Chairman and Members of the Subcommittee:

My name is William Reed and I am the Vice President and Treasurer of Williams College in Williamstown, Massachusetts. I am here today on behalf of the National Association of College and University Business Officers (NACUBO) and the other higher education associations listed on the cover of this testimony, together representing virtually every college and university in the nation.

It is my pleasure to be here today to discuss the concerns of the higher education community about the current insurance crisis and to offer our support and help as this committee develops a federal response to the crisis.

BACKGROUND

The recent national crisis in the insurance industry has created severe problems for many colleges and universities in every state. All insured areas of college and university operations are affected by the current market situation. Colleges and universities are having problems in obtaining basic and umbrella liability coverage including: directors and officers; risks related to errors and omission; environmental damage and hazardous waste disposal; medical malpractice; and athletics. Another problem area is property, casualty, and earthquake insurance. If coverage is available, the cost is exorbitant, thus causing a severe drain on college resources that could be better used in aiding needy students and supplying the research and educational facilities required to provide quality postsecondary education to current and future generations.

The scope of the problem can best be illustrated by citing a few recent examples. The insurance premium for general liability at the College of Wooster, in Ohio, for instance, rose from $88,000 in 1984 to this year's quote of $249,000. Hood College in Maryland was notified that its $10 million directors and officers policy would be cancelled eight months before the policy was due to expire. The company reinsuring Hood withdrew all of Hood's trustee liability policies after the company lost its protective reinsurance, which had been provided by a European firm. All other institutions insured by this carrier were similarly affected.

The trustee and fidelity bond policies were cancelled in 1985 for Princeton University. Southern Methodist University previously had fire insurance coverage of $325 million and was paying an annual premium of $103,000. The cost of SMU's renewal policy was $413,000 with a very large deductible of $100,000 on a quota-share basis, and 25 percent of every loss up to $5 million. Costs for coverage of all buildings and contents at the University of Southern California are likely to double, accompanied by an increase in the deductible. Additionally, the university decided to go uninsured for earthquakes when its premium for $100 million in coverage (with a $10 million deductible) jumped from $12,500 to $400,000. A recent court decision that is pending appeal makes the state of Georgia responsible for paying a claim of over $6 million to a former University of Georgia faculty member because the state university had no directors and officers liability insurance coverage at the time of the award.

As illustrated by these examples, the crisis is affecting all types of institutions across the nation and is depleting the already scarce financial resources needed to conduct the higher education missions of teaching, research and community service. In response to the crisis, colleges and universities have addressed the problems in a variety of ways. Solutions have included self-insurance, group purchasing efforts, cooperatives, creation of captive insurance companies, and development of consortia arrangements. While these mechanisms have provided a temporary solution for many institutions, there are still many colleges and universities "going bare," living with normally unacceptable exclusions and/or paying excessive costs. Additionally, while these solutions have provided immediate relief, the problem is such that a long-term answer, national in scope is required.

In response to this national insurance crisis, the National Association of College and University Business Officers, in cooperation with several other education associations, including the American Council on Education, the Association of Governing Boards of Universities and Colleges, the National Association Independent Colleges and University and the National Assoication Independent Schools, has formed a task force to review and study this issue and to seek solutions. The task force has already undertaken efforts to provide short-term answers, such as creation and dissemination of information on "how to" form captives, develop consortia, and set up group purchasing arrangements. In addition, the importance of sound and well-managed institutional risk management programs have been emphasized through publications and workshops. The task force is also focusing on long-term solutions to protect colleges and universities in the future from the whimsical cycles of the insurance market.

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Another on-going activity of the tas force involves a project undertaken by a group of university risk managers who are forming a "super trust" that will provide directors and officers coverage for institutions beginning July 1, 1986. All colleges and universities will be eligible to purchase coverage through this "super trust" arrangement, provided they meet certain requirements, such as developing a campus risk management program and sharing their complete claims history with the trust. Additionally, the task force is investigating the feasibility of a national higher education insurance company to provide excess liability coverage.

RECOMMENDATIONS FOR LEGISLATIVE CHANGE

The task force also has determined that a change in state and federal law is necessary to protect the consumer from the inconsistencies in the insurance industry. A sub-group of the NACUBO insurance task force is preparing model state legislation that institutions can discuss with their state representatives.

NACUBO believes the appropriate role of government is regulation of the insurance industry. Such regulation should focus on the following areas:

CLAIMS HISTORY: The industry should be regulated so that premiums are priced based on a client's loss history and background. Such a regulation would allow for negotiation of price, rather than the current arbitrary method of pricing used by the insurance industry.

<u>POLICY CANCELLATION</u>: Insurance companies should be required by law to complete the agreement they made when the policy was issued, specifically on policies written for annual renewal. Currently, companies may cancel policies with 60 to 90 day's notice. Such cancellations are generally based on financial changes in the insurance market, not on changes in the policyholders' condition. In other words, companies should not be allowed to cancel annual policies when there is no change in the nature of the business or the risk of the individual policyholder. Additionally, many customers prepay their premiums, and when policies are cancelled, funds may be lost.

NACUBO encourages close federal and state cooperation in addressing regulatory issues and compliance policies. In addition to such regulation of the insurance industry, the federal government may need to consider tort law revision. The judicial process is a major part of the claims/awards process and must be part of the solution in the insurance industry crisis.

For example, a standard approach to jury awards on justified claims is needed that would be consistent across state lines. Federal law could establish maximum liability awards that juries would follow in assessing the monetary value of claims. Such parameters will help prevent run-away awards and still provide fair and accurate reimbursement for losses.

Perhaps the federal government could offer financial incentives to states that are incorporating tort reform into their judicial systems. Such federal incentives could alert states to the need to examine their tort laws and to encourage review of their current systems.

It is also suggested that the issue be discussed on the national level, to increase public awareness of the severity of the problem. Areas that may be considered for discussion include: frivolous suits, joint and several liability, pain and suffering awards, punitive damages, and attorney and contingency fees.

The National Association of College and University Business Officers and the higher education community has started to develop creative alternatives in response to the current crisis in the insurance industry. There is still a need, however, for strong federal and state initiatives in this area.

The higher education community stands ready to help this committee in any way possible as it develops a federal policy for addressing the current insurance crisis.

I would be happy to respond to any questions that you may have on higher education's particular problems or on any part of our testimony.

Mr. FLORIO. Thank you very much. Mr. Hitselberger.

STATEMENT OF TOM HITSELBERGER

Mr. HITSELBERGER. I am Tom Hitselberger and I am chief financial officer of the Arcadian Corp. I have submitted my written statement but in addition to that I would like to take a few minutes to tell you about our company and the impact that dramatically increasing insurance is costing our company.

Arcadian Corp. is a major producer of liquid fertilizers. We employ 550 people in 22 States. We have major production facilities in Louisiana and Nebraska. We have 60 terminals in 23 States. Our headquarters is in New Jersey. Our annual sales are slightly in excess of $200 million. After raw material, wage and salary expenses, one of our most significant costs is insurance.

Our insurance year ends in June. The year ending in June 1985, our total insurance costs were $1,148,000. For the year ending in June 1986, our total insurance costs will be approximately $2,850,000, and when the final numbers are in, those costs might actually exceed $3 million. This is an increase of about 150 percent in just 1 year. The cost of every coverage has increased.

Our property and machinery costs increased by about 50 percent. Our heaviest increases by far are in liability insurance. In this area, the typical increases for us have been over 300 percent. In dollar terms, our liability insurance has increased by over $1,300,000. Despite a 300-percent increase in cost, our coverage has been decreased by 75 percent. Our liability coverage was $100 million a year ago and today it is $25 million. Even worse, because of the manner in which the liability umbrella insurance is structured, we have been forced to be self-insured to a great extent in all losses over $5 million.

We don't want to be self-insured. We want adequate insurance coverage. We are willing to pay for it. We can't get it.

We are classified as a chemical company by our insurers. An article in the Wall Street Journal on March 11 points out that chemical companies which previously had liability insurance in the hundreds of millions now often can't find more than $20 million of coverage The cost increases and the coverage reductions would be more understandable if our claim experience is bad. The opposite is true. Our claim experience is very good. Our liability claims in the last year were under $100,000.

The users of our product are the American farmers. There is no way that we can pass these increased insurance costs on to those customers. We have to absorb them, and not simply by reducing profits. For people in our business, other factors affecting the farm economy in our country in 1986 have already reduced those profits. For most, last year's profits are already being absorbed by this year's losses.

In the hearings today, I have heard quite a bit about the immediate effect of insurance and the lack of availability of insurance. I want to tell you that there is a ripple effect. It goes beyond insurance.

In yesterday's Wall Street Journal, there was a story pointing out that banks are becoming stricter in loaning to companies that

are having difficulty in getting liability coverage. Chemical companies are specifically mentioned as being in that group.

To the extent possible, we have reduced costs in other areas. Those cost reductions will have a future impact on us and our customers. The development of new and more cost effective product formulations will be reduced. New and more efficient methods of applying liquid fertilizer will be slower in coming. As these increases continue and our expectation is they will continue in this year but not at the same rate as last year, we will have to make further personnel reductions to stay in business.

I don't know how to solve the problem of increasing liability insurance costs. Maybe this brief presentation of a part of that problem and its impact on one company will help you to find a solution.

Thank you.

[The prepared statement of Mr. Hitselberger follows:]

STATEMENT OF THE FERTILIZER INSTITUTE

Mr. Chairman, my name is Tom Hitselberger, and I am Chief Financial Officer, Arcadian Corporation, headquartered in Parsippany, New Jersey. I appear here today on behalf of The Fertilizer Institute*.

Arcadian Corporation is a privately held independent fertilizer company. We market fertilizer primarily in the Eastern two-thirds of the United States with production facilities in Louisiana and Nebraska. We have major fertilizer terminal facilities in 22 states serving approximately 1600 distributors.

We appreciate this opportunity to present our industry's views regarding the current problems surrounding liability insurance and its negative impact on the fertilizer industry.

Understanding that this is a federal forum, we feel it is necessary to recognize at the outset that the insurance industry to date has been predominantly regulated at the state level. Therefore, we recognize the difficulty you encounter in trying to grapple with the significant market problem and provide a federal

*TFI is a voluntary, non-profit association whose members represent approximately 95 percent of the domestic fertilizer production in the United States. TFI's membership includes: producers, manufacturers, traders, retail dealers and distributors of fertilizer materials. Its members are major shippers, receivers, and exporters of fertilizer and fertilizer materials and are a vital link in the nation's agriculture system.

solution which could provide expedient relief. The Fertilizer Institute believes that immediate action should come from state regulators, but applauds the Congress for recognizing that this is a problem of national dimensions. Clearly, there are certain federal remedies which could be helpful and appropriate for a longer term approach to insurance problems facing America's businesses and consumers.

Perhaps the best way for me to begin is to provide a few examples which came to light in a recent polling of Institute members.

In our investigation, we found a doubling of premiums and significant reductions in general liability coverage to be commonplace. These increases in premiums and reductions in coverage occurred, for the most part, without regard to a company's previous claims record.

For example:

- A California company's coverage was reduced 95 percent, from $100 million to $5 million, while premiums remained at $150,000 and a pollution liability insurance clause was eliminated.

- A Washington state company experienced a doubling of premiums from $30,000 to $60,000 while its coverage was cut by more than half, from $11 million to $5 million.
- A Virginia company experienced a doubling of premiums from $25,000 to $50,000 and an 80 percent reduction in coverage, from $5 million to $1 million.
- A company in Maryland was paying $100,000 in premiums in 1985 for $5 million of coverage, but was dropped by its insurance carrier for 1986 despite a spotless record. This company contacted the Maryland State Insurance Commission with its problem and was reinstated -- but anticipates a drastic increase in premiums.
- A Kansas company that was paying $50,000 in premiums for $1 million of coverage was cancelled by its original carrier but then reinstated by another for the same coverage, paying 30 percent more in premiums.
- A company in Texas experienced nearly a doubling in premiums from $130,000 to $230,000 for the same coverage.

As you can see, the fertilizer industry has been directly impacted in several liability areas. We are impacted in transportation and product liability, as well as environmental and general liability. Much of this impact has been the direct result of federal policy -- some of which has precipitated the current insurance crisis.

For example, under current federal law, the Motor Carrier Act of 1980 requires carriers to obtain $5 million in liability coverage to transport hazardous materials. Some carriers are finding that the $5 million requirement is either impossible to obtain or prohibitively expensive. Some industry companies fear that, if carriers are unable to obtain sufficient insurance, they will not be able to transport fertilizer materials to customers -- including farmers. This is an example of a federal statute setting a minimum coverage limit at a time when the cyclical insurance industry was providing coverage at reasonable rates.

As you are aware, federal environmental laws and proposed legislation over the years have asserted liability schemes which have impacted the perceived responsibilities of companies, particularly in the area of environmental risks. Today we are at a point where few companies will even consider underwriting pollution liability -- and policies which are written tend to be both cumbersome and very limited in terms of allowable coverage.

Another key concern is product liability. Like transportation and environmental liability, we would suggest a strong link between federal actions and their effect on insurance. As this committee is charged with protecting interstate and foreign commerce of goods and services, it's important to note that today a company who functions by the

letter of the law must comply with 50 different standards and 50 different legal jurisdictions -- making it extremely difficult to comply. Also, one must acknowledge that these standards are in constant flux. It would appear to the fertilizer industry that federal statutes seeking to unify product liability would be a more consistent approach to ensure protection of public health and safety.

Most importantly, the cost and availability of general liability coverage is the predominant problem for the fertilizer industry.

Many of The Fertilizer Institute's members are or were involved in the reinsurance market, directly or indirectly. As you know, reinsurance spreads the risk and provides more available coverages within the market. Reinsurers have told many of our companies that they are wary of how contracts will be interpreted in our court system and that, until changes are made in that system, carriers will seek less risky markets for their insurance. The Fertilizer Institute urges examination of the applicability and fairness of adopting a cap on awards rendered by the courts. We do not come here with a formula or a road map to reform, but obviously this is a problem deserving congressional attention and action.

Recognizing the problems related to availability and cost of insurance, the fertilizer industry has sought several alternatives. First, many of our larger members have gone off shore to organize captive insurance groups. However, this is not a viable solution for many of our smaller farm retail centers. The Institute has encouraged them to actively seek assistance from state insurance commissioners, considering the severity of the problems, particularly those involving mid-term cancellations.

For this reason, The Fertilizer Institute commends legislation -- H.R. 2129 -- introduced by a member of the Energy and Commerce committee, Congressman Wyden. We strongly support formation of risk retention groups and federal legislation which will make self insurance more readily attainable. In closing, Mr. Chairman, we commend you for your personal commitment of time in examining the current lack of availability in the liability insurance market. Solutions to these problems are available. We encourage you to explore the applicability of federal legislation which can provide relief. In addition, a thoughtful look and discussion involving our civil justice system is timely and necessary.

We appreciate the opportunity to testify this morning and stand ready to work with you and the members of your committee and staffs.

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Mr. FLORIO. Thank you very much. It was interesting that all three witnesses maintained that loss pay-out certainly is not justification for premium increases. I think two of you at least made a suggestion that there should be some regulatory system that would condition premium increases in some way on the experience, that is the claims record experience. I think you all appreciate the fact that as wise as that sounds, some would regard that as a very radical proposal that would intrude into the traditional ways of dealing with insurance regulation.

In our State, Mr. Hitselberger, we have gone the direct opposite. We have virtually deregulated commercial insurance totally. The idea of reregulating it and then to regulate it in such a way as to condition the ability to change premiums on loss experience, while for those of us who are unsophisticated, it makes a whole lot of sense, it would be regarded as a very radical proposal.

Have you given any thought as to how we could even consider starting a debate on a process of that from this perspective? That is the Washington perspective?

Mr. HITSELBERGER. First, a lot of insurance is actually price based on actual claim experience, specifically property and machinery. There our premium rates relating directly to our loss experience. In liability, that is not the case.

Probably our biggest problem is twofold. One is the unwillingness or the inability, and I think it is the latter, of insurers to write chemical liability insurance. That is a very, very narrow market. It has in fact been restricted because of the increase in premiums. Effectively what has happened is if the premiums are doubled, the amount of coverage that a carrier can write is cut in half. That is usually done by State regulatory bodies.

We think that if there were the opportunity to group and say fertilizer companies, we think probably we do better. Frankly, I think that is not even a solution. The small groups or the small insurance groups, they are going to have to get reinsurance. They are going to tall back into that same basket. They are going to have to deal with the reinsurers.

Mr. FLORIO. Let's talk about that for a moment. I would like to get some specifics, Mr. Reed, if you have any, about the experience with trustee suits as well as trustee claims that have been made and trustee pay-outs. Do you have that type of information?

Mr. REED. I don't have details. In our task force, we have talked about this. We know of no trustees that have been successfully sued that serve on college boards.

Mr. FLORIO. This reinforces the point that this unavailability is not prompted by massive litigation and large judgments that have been awarded.

Mr. REED. Yes, sir.

Mr. RITTER. Mr. Chairman, will you yield on that point?

Mr. FLORIO. I would be happy to yield.

Mr. RITTER. I think this is a really critical point. The universities, the Fertilizer Institute or other institutions that exist throughout the economy which deal with chemicals, for example, are not necessarily dependent on their own experience for their insurance rates. The insurance company is not depending on their experience

per se for setting rates but is looking at generic items with which those institutions deal, like chemicals.

The potential is there. The deep pockets are conceivably there. There is some experience gained from these other circumstances whereby you all of a sudden, even though your own record is not bad, become a bad risk. You are dealing with chemicals. You haven't had a real problem but with Superfund or RCRA, however, with the kind of discussion we looked at before with potential future human harm out there, you all of a sudden become liable regardless of your own individual record because the system has done it to others.

I think that is part of the problem we face, Mr. Chairman. Thank you for yielding.

Mr. FLORIO. The suggestion has been made a couple of times today about risk retention groups. Mr. Reed, part of the attractiveness to this point of risk retention groupings has been the tax benefits, as nonprofits, one presumes you do not derive any benefits out of those provisions in the Tax Code. Notwithstanding that, do you still feel this type of proposal would be something of value to your type of organizations?

Mr. REED. Yes, sir. The reason is many colleges have a hard time getting the primary coverage they need for an umbrella coverage to take over. By joining together, we can provide the primary coverage, self insured, in essence, as a group and share the risks.

Mr. FLORIO. Your perception is that there is a need for expansion of the Federal law? Why? You are running into difficulties at the State level, which inhibit the formulation of these groups?

Mr. REED. It has not been a major problem. It is a problem where we cannot practice insurance ourselves as a college or university, so we have to have an insurance carrier to put us together that is represented in every State. Then in essence we insure that insurance carrier for the first part of the primary coverage. In other words, the colleges and universities can't by definition get into the insurance business.

Mr. FLORIO. Mr. Thomas, let me just say that I appreciate the support for the legislation that we have put in with regard to asbestos. I know of the difficulty architects as well as contractors and building people are having in trying to get coverage.

You concluded your statement with the observation that if we take this action in spelling out standards, that would somehow resolve the problem, the problem in terms of having insurance available. I am not as confident as you are that will resolve the problem because I am not sure anyone has really made the determination that really is the problem as far as the insurance industry is concerned.

In a different context, we talked in the area of toxic waste disposal and disposal facilities. When we spoke with insurance industry representatives about their suggestions about how to change some of our laws in a way they would find more acceptable, after we got done saying, what if we do all that, is insurance going to be made available, the answer was, no, we are not sure.

As desirable as it is, to give us the certifications and the certainty of having the law put into effect, I am really not sure that is going to solve the problem. As you have observed, it certainly

makes a lot of sense to provide for those types of standards as are contained in the law and hope for the best and address the next problem that someone is going to present to us as to why they don't want to provide insurance coverage.

I appreciate your comments.

Mr. THOMAS. I completely agree with you. It is one small step in the overall solution. What we hope that the Federal standard of care will do is make the insurance companies take a harder look at their exclusions regarding asbestos. If we have a standard of care which will allow people involved in the abatement process to work within recognized and established guidelines, then that could conceivably become a defense in the event of a claim arising from that work.

Mr. FLORIO. As well as reducing the hazard, the opportunity for the hazard in the first place.

Mr. THOMAS. Absolutely. Right now there are just too many situations where unqualified contractors are removing asbestos and making the problem worse than it actually is. I agree completely that what we are trying to do is make things more attractive for the insurance industry, but it is a small part of a much larger problem.

Mr. FLORIO. I will yield to the gentleman from Pennsylvania.

Mr. RITTER. I thank the gentleman for yielding.

Mr. Reed, in your written testimony, you point out or suggest that this issue be discussed on the national level to increase public awareness in the severity of the problem. You go on to say that areas that may be considered for discussion include frivolous suits, joint and several liability, pain and suffering awards, punitive damages and attorney and contingency fees.

Mr. Hitselberger, in your testimony, you talk about a thoughtful look and discussion involving our civil justice system is timely and necessary.

Mr. Thomas, I know architects are very much concerned about getting liability insurance just to practice as professionals and malpractice is now not just limited to doctors but also extending out to engineers and architects as well. Is that correct?

Mr. THOMAS. Yes, it is.

Mr. RITTER. Do you agree with the comments of your colleagues on the other matter, the civil court system, the tort system?

Mr. THOMAS. I do. There is a definitive need for tort reform. The AIA is working with several other professional societies in a joint effort to try to develop solutions to the tort reform problem.

Mr. RITTER. I think you are involved in the ATRA group?

Mr. THOMAS. Yes; we are.

Mr. RITTER. The American Tort Reform Association.

Mr. THOMAS. We are also working with the Interprofessional Council of Environmental Designers on alternatives to the present system, to try to provide products that will be more meaningful to professionals and on the other hand, working on the question of tort reform.

Mr. RITTER. Mr. Reed, in your testimony on page 2, you discuss a court decision that makes the State of Georgia responsible for paying a claim of over $6 million because the State university did not have liability insurance at the time of the award.

What do you feel about these kind of high awards? Do you feel that some tort reform is necessary?

Mr. REED. Yes; I do. It is a complex issue, as you know. It seems to me that common sense and logic often would tell you that the amount of damage done is not important.

Mr. RITTER. I think we can all accept that expanding the use of risk retention is going to help deal with the symptoms of the problem but there may be a deeper problem than just forming groups to share the costs. The costs may be continuing to rise and expand and those groups are going to conceivably be at risk as insurance companies. I have a feeling that the court system will recognize somewhat the idea that there is a self-insurance mechanism, that there is a responsibility that is right there in your own neighborhood as opposed to some insurance company that is located in Hartford, CT.

Yesterday, the Reagan administration proposed an overhaul in this area. It talked about a return to the concept of fault based liability.

Do you have any problems with that concept? I am just trying to get some very brief feedback.

Mr. REED. I haven't seen the proposal.

Mr. RITTER. Let me just read through some of these things and then what we could do is for the record supply your comments on some of these issues. I think that would be very interesting for our subcommittee.

Major features of the Reagan administration's recommendations is a return to the concept of fault-based liability restricting the liability to whoever is found to be at fault. And this goes on to talk about the increasing application of strict liability, which is not the same thing.

A restriction joint and several liability under which any one of several parties could be held liable for the damage caused by a single incident. And it talks about an absolute dollar limit on non-economic damage awards, judgments designed to punish a defendant or compensate a plaintiff for pain and suffering.

It talks about a procedure to link damage awards to the duration of the damage. It talks about limits on attorney's fees and this would restrict the amount of contingent fees received by lawyers, something bound to be highly controversial.

And limits on the practice of seeking damage awards from several different sources, which some officials say create a kind of double dipping in which several insurers pay for the same accident.

Do you have any problems with the overall thrust of the proposal?

Mr. REED. It sounds like it would be a major step forward.

Mr. RITTER. Do you have any comment on that?

Mr. HITSELBERGER. No; I agree with that. I think the extension with the fact or the appearance that the court seems to have extended liability has really been harmful. And I think anything that can shrink that will be a plus.

Mr. RITTER. Do you have a comment?

Mr. THOMAS. I have no problem with it. It is advantageous, especially for architects. In the building industry. We ultimately really do not control the end product of our work. We design a building.

A contractor then builds the building and can—all sorts of things can happen during that construction process which are beyond our control, which exposes us to risk.

Mr. RITTER. You have the responsibility of the designer.

Mr. THOMAS. Yes; and then ultimately the owner takes over the building and maintains it and a great many claims arise out of his lack of maintenance, so that anything that really strictly defines liability and points the finger where it properly belongs, is something that sounds reasonable.

Mr. RITTER. I think if we could have, for the record, a letter from each of you bringing out your feelings of various aspects of tort reform, I think it would be helpful to the committee and we would make that—if the chairman allows it.

Mr. FLORIO. We would be happy to receive your responses.

Mr. FLORIO. I might just—and this is not the place to go into a long explanation of all the points. Are any of the members lawyers? Mr. Ritter is not a lawyer either.

The difficulty with adopting the general validity of the principles is that the principles apply most of the time, except in the difficult cases where they do not apply. And that has been the difficulty. When you have finding of faults among multiple defendants and you cannot apportion the damages, that is when joint and several liability comes in.

So it is fine to be in favor of the general principles. The general principles, however, go off the beaten path when you have these difficult situations, so that I would subscribe to the same points, for the most part.

It is nice, but irrelevant to the major problems that we are facing in the real world.

I will look forward to your letters, as well, but you might want to run them by your lawyers, so that you can have them submitted in the ways that are relevant to real world considerations.

Let me thank you very much for your participation today and tell you that you have been very helpful.

Thank you very much.

[Whereupon, at 12:15 p.m., the hearing was adjourned.]

[The following statements were submitted for the record:]

CENTER FOR NON-PROFIT CORPORATIONS

Testimony of
Betty Wilson, President
Center For Non-Profit Corporations
before the
Subcommittee on Commerce, Transportation and Tourism
of the
Committee on Energy and Commerce
U.S. House of Representatives
The Hon. James Florio, Chairman
March 19, 1986

Thousands of New Jersey non-profit groups and the millions of people they serve each year are suffering from the liability insurance crisis. Staggering liability insurance premium increases, threats of cancellation and non-renewal, reductions in coverage and demand for payment within a few days are all too common practices over the last eight or nine months in New Jersey. Until premiums are brought under control and good sense returns to the insurance marketplace, the problem will worsen.

I would like to describe just a sampling of the many cases that have been reported to us at the Center.

The liability insurance premium was doubled for a multi-service community based organization that provides day care, tenant counselling, a shelter for juveniles and other services in a low income urban neighborhood, last October. They could not afford the new $20,000 premium. They shopped around for another policy and found an Arizona Company that wrote a policy at lower cost but also offered less coverage. They felt they had no choice but to take what they could afford. At Christmas time, their building was broken into and the toys they'd collected for neighborhood children for Christmas gifts and their computers were stolen. The new policy didn't cover the loss.

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An arts and music school and cultural center in South Jersey was notified, one Friday in November, that they had until 4:00 p.m. that day to choose to renew their liability insurance, at nearly ten times their last year's premium or be dropped for non-renewal. They paid because they had no alternative.

A food bank in Essex County that provides food at little or no cost, for groups serving the poor and needy, was given two days to pay a renewal premium of $5900 for their Directors and Officers Liability policy. Last year the policy cost $590.

A Head Start agency was slapped with a premium increase of 2000%. When their policy renewal came, the premium went from $631 to $13,200. After shopping around they found another company that would insure them for $6,125. Though nearly ten times their cost of last year, it looked like a bargain.

A community mental health center in Camden County that works with deinstitutionalized mentally ill people, recently expanded its services to the entire county and changed its name. Their coverage was cut from $1 million to $100,000 in mid-stream.

One Head Start agency in Passaic County, was first threatened with non-renewal and then was given verbal assurances that the company would renew. More than a month after the policy year ended, they still had no renewal policy, no binder and no bill for the premium. Six weeks into the policy year a three-month binder came and a bill for a deposit that was equal to the previous year's full premium. Almost three months into the policy year they were billed $8,850 for coverage that cost $2,500 the year before.

A YWCA in Camden is paying almost 300% more in premium for reduced coverage. Their director writes:

> "It is impossible for an agency such as ours to pass along even a portion of the rate increase to our customers We are providing primarily child care services at our Camden site. In Camden, the average per capita income falls 16% below the poverty level, and the Brookings Institute has described the city as the ninth most distressed in the nation. Nor are we able to pass along the rate increase to our primary funding sources, the United Way of Camden County and the State of New Jersey (Division of Youth and Family Services).
>
> The situation with Professional Liability Insurance which we carry for the counseling staff at our battered women s shelter (SOLACE) is similar. In this case, our policy was renewed, but the rate increase between 1985 and 1986 was a staggering 500%. Once again, the new policy with the higher rates provides reduced coverage "

Non-profit groups can't afford to take the risk of "running bare" - operating without liability coverage. Our Board members are volunteers who cannot be expected to take the personal risks of being uninsured. Furthermore, prudent management compels a non-profit board of trustees to carry liability insurance Non-profits with state contracts are required by law to carry insurance.

It is not that these organizations have filed a lot of claims or have had large judgments paid out on their behalf. In no case reported to us was there any record of claims made or paid. All the evidence we have shows that bad claims experience plays no part in the rising insurance costs. In fact, a survey of New Jersey day care centers shows they're such good risks that insurers ought to be clamoring for their business. According to a report from Nicholas Scalera, Assistant Director of the New Jersey Division of Youth and Family Services, 81 3 percent of day-care centers surveyed reported no claims over the 1980-1985 period. Of the claims settled, 67 percent involved awards of under $200 each

Refuting claims about child sexual abuse risks in day-care settings, Scalera said, "Of 44,000 reported cases of abuse and neglect in 1984, only 200 involved child-care centers. That's less than one-half of 1 percent Only 18 of the 200 were substantiated " That's a miniscule .0004 of the reported cases

Non-profits are willing to pay a fair price for a quality product. We're certainly not asking for a free ride. In New Jersey alone we estimate non-profits paid $50 million or more a year in premiums -- and that's before the prices went up. Insurance companies are businesses and are entitled to make a reasonable profit. Yet, the insurance industry should not possess unbridled flexibility to raise premiums suddenly, capriciously and without warning. Poor business judgment within the insurance industry is largely responsible for the current crisis. Insurance companies miscalculated in the early '80's when they were in hot pursuit of premium dollars. They then failed to heed early warnings of the impending crisis which were evident as long as two years ago.

In a last-minute scramble to recover, the property and casualty insurance industry has effectively redlined whole segments of the economy -- non-profits, governments and some businesses. They've gone too far.

Non-profits are especially vulnerable in the current crisis. Most do not have financial reserves to cover huge premium increases. These are groups that our country relies on to provide essential community services, often to our neediest citizens. In most cases prices cannot be raised. We can turn only to private contributors or to government to help pay these added insurance costs. That means that hard-won charitable gifts, client fees and taxes will be spent for insurance premiums rather than to care for children, the sick and the elderly. That is neither good sense nor good public policy.

We believe that significant institutional change is needed to halt this crisis and to stem the cycle of insurance crises in the future. We recommend that Congress assume a role in insurance regulation and standard setting.

Our State Insurance Department is too understaffed, especially with actuaries, to keep on top of insurance rate and policy changes. Information on rate

changes was reported to the department in the years after deregulation. Yet, reports either went unread or warning signs unnoticed, allowing the current situation to build to a crisis. Congressional oversight is needed to support the states.

The insurance industry is national, even international in scope. No single state can hope to have the resources or the power to protect its citizens from forces so far outside its control. For example, international companies write 67% of the reinsurance for U.S. insurance companies. They have refused to provide reinsurance in many cases, leaving American property and casualty companies without needed reinsurance. Action by Congress is needed to guarantee that reinsurance will be available at a reasonable cost.

We suggest repeal of the exemption of the insurance industry from federal anti-trust laws (McCarren-Ferguson Act).

We support H.R. 4301 sponsored by Congressman Wyden and S-2129 sponsored by Senators Kasten, Danforth, Hollings and Rockefeller. We believe this proposed legislation which removes impediments to risk pooling for general liability coverage, will provide limited relief for some organizations.

Because of the overriding public policy consequences of the insurance crisis, Congress should guarantee a back-up system that would assure availability of liability coverage in adequate amounts to all at reasonable rates. The system could be modelled after the FAIR plan which was set up to guarantee fire insurance after the urban riots twenty years ago. While individual states could pass laws to accomplish such relief, there is little indication of widespread action to do so.

Finally, we believe Congress should require disclosure of insurance industry data and information about income and claims paid. Only then can an accurate assessment be made as to whether rates are reasonable and substantiated.

National standards would ensure that insurance companies would not have to comply with fifty different sets of reporting requirements and would provide Congress with uniform data for oversight purposes. New Jersey's Department of Public Advocate's statement to the New Jersey Insurance Department on "the Proposed Exclusion of Certain Coverage from Commercial Liability Insurance Policy Forms" (March 6, 1986) says:

> "While New Jersey and the rest of the country have been barraged over the past few months with a variety of lamentations and anecdotes from the insurance industry, the Public Advocate has been very troubled by the lack of hard, empirical data to back up the industry's rate increases and reductions in coverage. Despite repeated calls for this data from this Department, other public officials and concerned individuals, the industry has been intransigent in its refusal to disclose this vital information. Instead, the industry's positions and actions have often been premised on mere conjecture and subjective speculation. Requests for significant changes in coverage have thus been made without the industry ever providing the actuarial information which would objectively verify the actual extent of losses incurred by the industry in providing the particular coverage. Of equal importance, the industry has not demonstrated that substantial changes in coverage or withdrawal from a particular line are necessary to alleviate any legitimate problems insurers may have. Indeed, when limited empirical information is made available, it is never set in the context of being cycle-bottom data, suggesting a calculated effort to use these unrepresentative figures to manipulate public policy.
>
> This lack of data is even more intolerable in view of the fact that many of the proposals that have been made by the insurance industry would have a dramatic effect on social and public policy in New Jersey. Because of the critical role insurance coverage plays in our society, any changes which would limit the availability or the protection it provides should be scrutinized with the utmost care."

In conclusion, I want to thank you Mr. Chairman and members of the Committee for your concern and interest. The people I work with and the people they serve are suffering from this crisis which they did not cause, for which they bear no fault and over which they have no control. We ask your help in bringing equity and justice to the insurance system in our country and to relieve the hardships we are suffering under.

Statement of
The Petroleum Marketers Association of America

The Petroleum Marketers Association of America (PMAA) appreciates the opportunity to submit for the record this statement regarding the liability insurance crisis. PMAA, formerly the National Oil Jobbers Council, is a federation of 41 state and regional trade associations representing approximately 11,000 small independent petroleum marketers (see Attachment A). Collectively, these marketers sell half the gasoline and over three-quarters of the home heating oil consumed in America today. While virtually all of these marketers are small businessmen, if one combined their collective assets, they would rank 17th on the Fortune 500's list of companies. Attached is a copy of a statistical quick reference sheet on PMAA which should assist you in understanding the scope of independent petroleum marketing (see Attachment B).

As you can see, the marketers we represent have a substantial investment in their businesses, an investment they do not want to see lost because of the unavailability or unaffordability of liability insurance.

The Petroleum Marketing Industry

Before explaining the nature of our particular insurance problem let me first elaborate on the petroleum marketing industry and the role of the independent marketer. Petroleum marketing can basically be broken down into three levels: manufacturing or refining, wholesale distribution and retail sales.

In reality, however, the lines are not so neatly drawn. Major integrated oil companies control the vast majority of the refineries operating in the U.S. today and are the source of much of the product an independent marketer purchases. These major companies, however, do not limit themselves to crude oil production and refining. Many also both wholesale and retail gasoline, home heating oil and a wide array of other petroleum products.

Oftentimes these major companies operate in direct competition with their wholesale customers for retail business. While this can and has created a multitude of problems for independent marketers, it creates one particular problem directly related to insurance. Most of the major companies self-insure their risks, therefore, they may be largely unaffected by insurance availability and affordability problems. However, independent marketers are generally not large enough to self-insure and must purchase insurance in the open market. Theoretically, if the cost of insurance increases, that higher cost could be passed through to the ultimate consumer. However, because marketers compete with major companies that self-insure and thus do not experience the higher costs, many marketers may have to absorb the higher premiums.

As indicated, independent marketers purchase their product from a refiner. Many marketers then transport that product in their own trucks. In order for these trucks to be admitted to a supplier's terminal, however, they must have certificates of insurance. Without such an insurance certificate a marketer's trucks could be banned from its supply source. This would require a marketer to utilize a common carrier. This in itself would not constitute a major problem since some marketers use common carriers almost exclusively. But as can be attested to by associations representing such carriers, they also are encountering incredible problems in acquiring insurance.

Once the product is loaded into a marketer's truck it generally goes either to its ultimate destination (i.e. a service station, a commercial account, etc.), or it goes to an intermediate terminal or bulk plant owned by the marketer. These bulk plants are generally above ground storage facilities at which product is kept until it is reloaded in smaller trucks to be distributed to smaller service stations, farmers, and homeowners (in the case of home heating oil). Product that goes to the service stations, to farmers and to commercial accounts (i.e. truck fleets, cab companies, etc.) is generally stored in underground tanks.

This is a simplistic explanation of the product distribution process. Some marketers, for example, may receive product by barge or by pipeline. But this explanation does provide a framework for identifying the possible risks for which most marketers need insurance.

Insurance Availability and Affordability

The risk perceived by many to be the greatest and the most difficult to insure for a marketer is the storage of petroleum produ .s in underground tanks. Public attention has focused on isolated incidents where tanks have leaked and gasoline has seeped into the basements of homes. So-called "experts" have warned about the potential problem leaking underground tanks pose.

The facts, however, simply do not substantiate the magnitude of concern over the problem nor do they substantiate the difficulty marketers face in acquiring insurance for these tanks. In fact, the major insurance carrier for petroleum marketers, Federated Insurance, has indicated that in 1985 the average loss on an underground tank claim was only $29,000. This is contrasted to 1983 when the average loss was slightly over $50,000 per claim. The number of claims has, however, increased steadily. In 1985 Federated reports there were 134 claims. The lower cost per claim and greater number of claims can be attributed to the fact that marketers are taking more precautions in the installation and monitoring of their underground tank system. They are detecting potential problems at a much earlier point in time, hence the lower cleanup costs.

Marketers have an inherent economic interest to monitor their underground tanks and to take every reasonable precaution against leaks. Petroleum products are a valuable commodity. Until very recently, a marketer may have had up to $1.00 per gallon invested in product in those tanks. He has every incentive to prevent the loss of any of that product in any form.

Despite all of this, underground petroleum storage tanks are being lumped with hazardous waste disposal sites and chemical storage facilities in the eyes of many insurance companies and reinsurance companies. Many of these companies are now unwilling to do what they are supposedly in business to do, that is assume risks even when the risk is a reasonable one from a historical perspective, as is the case with underground storage tanks.

As a result of the increasing difficulty in obtaining pollution liability insurance and the higher cost when it is available, many marketers are choosing not to purchase such insurance. "Going bare" is clearly not in the long term interest of any of us.

The insurance problem which exists is not limited however, to the availability and affordability of pollution liability insurance. It includes general liability insurance as well. PMAA conducted a random sample of its members to determine the seriousness of the liability insurance crisis. What we found was very interesting. The average premiums in 1985 paid by the independent marketer who responded to the survey was $36,175. This compares with $13,648 in 1983, a 165 percent increase in two years. The coverage obtained for this insurance decreased slightly between 1984 and 1985 and the deductible increased. The cost per dollar of insurance coverage, adjusted for deductibles, increased by 146 percent in two years. In contrast to these higher premiums, the claims awards returned to marketers has actually decreased by 24 percent in the same two year period.

Of those marketers that responded, 35 percent indicated that their company had been non-renewed or cancelled in the last two years. Once cancelled the average time it took to get new coverage was two months. Some marketers reported that it had taken them up to four months to acquire new coverage. On average, marketers received approximately two months advanced notice of cancellation or non-renewal

While the average time frame for notices of cancellation or non-renewal seem to correspond well with the average time it takes a marketer to find a new carrier, it is interesting to note that some marketers received as little as one day's notice of cancellation or non-renewal. This obviously places that marketer in an incredibly difficult situation since he no longer has a certificate of insurance and can no longer send his trucks to supply terminals to pick up product.

Interestingly, the reasons given for termination or non-renewal varied, but the most frequent was that the carrier no longer was interested in providing coverage to our industry. This supports the theory that insurance companies in the late 1970's and early 1980's were more interested in chasing the premium dollar than they were with loss ratios. A number of companies began writing insurance at discount rates in order to acquire marketer business.

Now that the market has firmed considerably, these companies are no longer interested in offering coverage to petroleum marketers. The results of this market withdrawal have been to place an incredible strain on those few companies left which still offer coverage. One company still interested in marketer business had to suspend taking on any new business for a period of two and one half months because it had reached its acceptable capacity levels.

The other effect of the market withdrawal by companies no longer interested in marketer business is a significant lessening of competition. The results of the PMAA survey show that one company supplies coverage to over half of the marketers that responded.

Possible Solutions

Evaluating possible solutions to this dilemma is difficult, particularly for an association such as ours which is not in the insurance business. Some have argued that the easiest course is to do nothing. The insurance industry is cyclical and market conditions will eventually improve. We have difficulty accepting that argument. Many marketers may be unable to ride out this cycle. Moreover, what causes the cycle in the first instance and what steps can be taken to prevent it from recurring?

We also do not adhere to the philosophy that the source of the problem lies exclusively in reform of our tort laws or in a total restructuring of the insurance industry. We generally believe the cause of the crisis is widespread and the solutions must address each aspect of the problem.

From the perspective of the businessman we have to become better risk managers. We must take every step possible to reduce our liability and the liklihood of accidents occurring.

Our civil justice system must also be examined closely with an eye toward more accurately defining and assigning liability based more on who is at fault rather than who has the deep pockets.

The insurance industry must recognize that it has not been the model of efficiency in the past several years and that an industry with such a dramatic affect on the commerce of this country must expect federal scrutiny.

Finally, the federal government must assert itself and acknowledge that this is a problem far beyond the boundaries of individual states and that some of the problem is a direct result of laws that have been passed that, although well intentioned, have contributed to increasing substantially the liability insurance companies face.

With this in mind, PMAA would like to offer several recommendations for the subcommittee's consideration:

First, Congress should consider making available insurance for those areas which private carriers are reluctant to insure such as pollution liability. While pollution liability coverage may be currently available for underground tanks, it is available on a greatly restricted basis and there are constant rumors that it may not be available at all in the future. Some industries already are unable to obtain pollution liability coverage. To deal with this problem Congress should make available such insurance with a program similar to the Federal Flood insurance or riot insurance programs.

Secondly, our civil justice system must be modified considerably. While PMAA is still analyzing the recommendations of the Tort Policy Working Group at the Department of Justice, we believe that many of their suggestions may have merit. These include the retention of fault as the basis for liability; that joint and several liability be eliminated; that punitive damages and pain and suffering awards be limited to a fair and reasonable amount; and that alternative dispute resolution mechanisms be developed.

Finally, Congress should consider the enactment of federal minimum standards for state regulation of the insurance industry. This would bring about a level of consistency in state regulation. In addition, the antitrust exemption insurance companies have under the McCarran-Ferguson Act should be re-examined to determine the extent to which the exemption is still justified. The question of whether the antitrust exemption has been a contributing factor to the current crisis should also be examined. The fundamental question is -- Should an industry with as great an impact on millions of businesses as the insurance industry has be totally exempt from any consistent federal scrutiny?

Attachment A

MEMBERS OF THE PETROLEUM MARKETERS ASSOCIATION OF AMERICA

The Petroleum Marketers Association of America represents the independent petroleum marketers who are members of these state and regional trade associations:

Alabama Oilmen's Association
Arizona Petroleum Marketers Association
Arkansas Oil Marketers Association, Inc.
California Independent Oil Marketers Association
Colorado Petroleum Marketers Association
Independent Connecticut Petroleum Association
Florida Petroleum Marketers Association
Georgia Oilmen's Association
Idaho Oil Marketers Association
Illinois Petroleum Marketers Association
Indiana Oil Marketers Association, Inc.
Petroleum Marketers of Iowa
Kansas Oil Marketers Association
Kentucky Petroleum Marketers Association
Louisiana Oil Marketers Association
Michigan Petroleum Association
Mid-Atlantic Petroleum Distributors Association, Inc.
Mississippi Petroleum Marketers Association
Missouri Oil Jobbers Association
Montana Chapter, Western Petroleum Marketers Association
Nebraska Petroleum Marketers, Inc.
Independent Oilmen's Association of New England
Fuel Merchants Association of New Jersey
New Mexico Petroleum Marketers Association
Empire State Petroleum Association
North Carolina Petroleum Marketers Association
Northwest Petroleum Association
Ohio Petroleum Marketers Association
Oklahoma Oil Marketers Association
Oregon Petroleum Marketers Association
Pennsylvania Petroleum Association, Inc.
South Carolina Oil Jobbers Association
South Dakota Petroleum Marketers Association
Tennessee Oil Marketers Association
Texas Oil Marketers Association
Virginia Petroleum Jobbers Association
Washington Petroleum Marketers Association
Western Petroleum Marketers Association
West Virginia Petroleum Marketers Association
Oil Jobbers of Wisconsin, Inc.
Wyoming Petroleum Marketers Association

The Petroleum Marketers Association of America is located at 1120 Vermont Avenue, N.W., Suite 1130, Washington, D.C. 20005. Telephone (202) 331- 198.

Attachment B

PMAA

PETROLEUM MARKETERS ASSOCIATION OF AMERICA
1120 VERMONT AVE. NW • SUITE 1130 • WASHINGTON DC 20005 • (202) 331-1198

PETROLEUM MARKETERS ASSOCIATION
OF AMERICA
STATISTICAL QUICK REFERENCE SHEET
1984 DATA

NUMBER OF MARKETERS REPRESENTED		10,[illegible]
TOTAL VOLUME OF REFINED PRODUCTS SOLD		82 BILLION GALLONS
EMPLOYMENT		239,672
FULL TIME EMPLOYMENT		177,416
PART TIME EMPLOYMENT		62,256
PERCENT OF U.S. TOTAL REFINED PRODUCTS		34.4%
MOTOR GASOLINE		50.0%
DIESEL FUEL		59.1%
NO. 2 FUEL OIL		75.5%
NUMBER OF MARKETERS BY PRODUCT	NUMBER	% OF TOTAL
HEATING FUELS ONLY	1,078	10.2%
MOTOR FUELS ONLY	3,942	37.3%
BOTH HEATING & MOTOR FUELS	5,548	52.5%
TOTAL	10,568	100.0%
COMBINED ASSET SIZE OF MARKETERS		$15.1 BILLION
TOTAL MOTOR FUELS RETAIL FACILITIES SUPPLIED		99,967
TOTAL MOTOR FUELS RETAIL FACILITIES OWNED		46,046
TOTAL NUMBER OF CONVENIENCE STORES OWNED		14,235
HEATING FUELS DISTRIBUTION CHANNELS		% OF PRODUCT
RESIDENTIAL		63%
COMMERCIAL		18%
OTHER FUEL OIL MARKETERS		5%
INDUSTRIAL		8%
OTHER		6%
MOTOR FUELS DISTRIBUTION CHANNELS		% OF PRODUCT
DIRECT OWNED & OPERATED		30%
LESSEE DEALER		14%
OPEN DEALER		21%
BULK END USERS		30%
OTHERS		5%
BULK STORAGE CAPACITY		1.7 BILLION GALLONS
NUMBER OF BULK STORAGE FACILITIES		10,567

Source: Petroleum Marketers Association of America

Formerly National Oil Jobbers Council

 958 (888)